Report to	Cabinet	**Item**
	07 February 2018	7
Report of	Chief finance officer (Section 151 Officer)	
Subject	Treasury Management Strategy 2018-19	

Purpose

To recommend to council the capital prudential indicators and limits, the borrowing strategy, the treasury prudential indicators, the minimum revenue provision

Recommendation

To recommend to council for approval:

(1) The Capital Prudential Indicators and Limits for 2018/19 through to 2020/21 contained within paragraphs 16 - 43 of this report and Appendix 1.

(2) The Borrowing Strategy 2018/19 through to 2020/21 (paragraphs 26 – 30).

(3) The Treasury Prudential Indicators (paragraphs 31 - 38), including the Authorised Limit (paragraph 36).

(4) The Minimum Revenue Provision (MRP) policy statement contained in paragraphs 60 - 65 and Appendix 1.

(5) The Investment Strategy 2018/19 (paragraphs 66 - 90) and the detailed criteria included in paragraph 74.

Corporate and service priorities

The report helps to meet the corporate priority value for money services.

Financial implications

The report has no direct financial consequences however it does set the guidelines for how the council manages its borrowing and investment resources.

It outlines the council's prudential indicators for 2018/19 through to 2020/21 and sets out the expected treasury operations for this period. It fulfils three key elements required by the Local Government Act 2003:

- The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The Minimum Revenue Provision (MRP) Policy, as required by Regulation under the Local Government and Public Involvement in Health Act 2007 (Appendix A); and
- The treasury management strategy in accordance with the CIPFA Code of Practice on Treasury Management.

The investment strategy is in accordance with the Department of Communities and Local Government investment guidance.

Ward/s: All wards

Cabinet member: Councillor Kendrick - resources

Contact officers

Karen Watling, chief finance officer	01603 212440
Tina Stankley, senior technical accountant interim	01603 212562

Background documents

None

Report

Background

1. The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when needed. Surplus monies are either used as a temporary source of funding for capital expenditure or are invested in low risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity but also to generate an investment return.
2. The second main function of the treasury management service is the funding of the council's capital programme and any resulting borrowing need of the council. The management of longer term cash may involve arranging long or short term loans, or using longer term cashflow surpluses. On occasion any existing debt may be restructured to meet council risk or cost objectives.
3. CIPFA defines treasury management as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Changes to CIPFA's Prudential Code and DCLG's Investment Code

4. CIPFA issued a revised Prudential Code and Treasury Management Code on 21 December 2017. The first code governs local authority borrowing (except HRA borrowing) and the latter code governs local authority investment, cash flow and risk decisions. Both of the revised codes are in response to developments arising from the Localism Act 2011, namely the fact that many councils are using the general power of competence to engage in increased commercial activity.
5. The key changes are the requirement to produce a capital strategy with the intent of the remaining changes being a strengthened and greater transparency required over non-treasury related investments such as commercial property acquisition and on-lending to third parties.
6. Both of the above codes will be effective for the 2018/19 financial year. However CIPFA recognises that the requirement to produce a Capital Strategy may need a longer lead-in period. Therefore whilst CIPFA recommends that the requirements of both codes are implemented as soon as possible it recognises that they may not be able to be implemented until the 2019/20 financial year. It is proposed that the capital strategy along with the other minor changes within the Treasury Management Strategy for Norwich City Council will be developed for approval by Council as part of the 2019/20 budget cycle.
7. Alongside this, the Department for Communities and Local Government (DCLG) closed a consultation on proposed changes to the Local Authorities Investment Code and MRP (Minimum Revenue Provision) Guidance on 22 December 2017. It is unknown when DCLG will issue the new code or what their response will be to the comments they have received from the

consultation. There are overlapping and some possibly conflicting issues between CLG's and CIPFA's codes.

8. As there is no conclusion as yet for this consultation, none of the proposals have been incorporated into the Treasury Management Strategy and MRP Policy. Again as with the CIPFA's revised code any required changes will be implemented as part of the 2019/20 budget cycle.

Reporting requirements

9. The council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.
    - **Prudential and treasury indicators and treasury strategy (this report) - This first and most important report covers:**
        - the capital programme (including prudential indicators);
        - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators;
        - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time); and
        - an investment strategy (the parameters on how to manage investments).

    - **A mid-year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

    - **An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Treasury Management Strategy for 2018/19

10. This strategy for 2018/19 covers two main areas:

- **Capital issues**
    - the capital programme and the prudential indicators (paragraphs 16-23);
    - the minimum revenue provision (MRP) policy (paragraphs 59-64, Appendix 1).

- **Treasury management issues**
    - the current treasury position (paragraphs 26-29);
    - treasury indicators which limit the treasury risk and activities of the council (paragraphs 30-45);
    - prospects for interest rates (Appendix 3);
    - the borrowing strategy (paragraphs 48-51) ;
    - policy on borrowing in advance of need (paragraphs 52-54) ;
    - debt rescheduling (paragraphs 55-57);
    - the annual investment strategy (paragraphs 65-69);
    - creditworthiness policy (paragraphs 70-73); and
    - the policy on use of external service providers (paragraphs 93-94).

11. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

Training

12. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. The chief finance officer will review what training has been undertaken in the recent past and develop a training plan.

Treasury management consultants

13. The council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

14. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

15. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Capital Prudential Indicators 2018/19 – 2020/21

16. The council's capital expenditure plans are the key driver of treasury management activity. The output of these plans is reflected in the prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

17. It should be noted that the figures included in tables below are based on several assumptions. These are:
    - The 2017/18 budget is the current approved capital programme and it's funding for 2017/18.
    - There is currently an anticipated underspend on the capital programme for 2017/18. The actual outturn figures 2017/18 will be presented in the 'Treasury Management Full Year Review' report to Cabinet later in the year. The full year review will compare the outturn to the budget and will show the variation from the figures in this Treasury Management Strategy.
    - The 2018/19-2020/21 estimates are the proposed estimates in the Cabinet report '2018/19 Budget, Medium Term Financial Strategy (MTFS) and HRA Business Plan' which is being presented at this meeting
    - The capital programme, funding, borrowing and CFR figures do not include any capital schemes that are currently in the planning stage and will require a business case and subsequent approval.

Capital expenditure

18. This prudential indicator is a summary of the council's capital programme, both that agreed previously, and the budget included in the budget report to Council. See table 1 below.

Table 1- Summary of the council's capital Programme (Prudential Indicator 1)

Capital expenditure £'000	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund	6,600	75,182	42,792	13,980	14,510
HRA	27,135	59,345	31,572	26,355	29,252
Total	**33,735**	**134,527**	**74,365**	**40,335**	**43,762**

19. The table below shows how the capital expenditure is to be financed immediately i.e. through the use of capital receipts, capital grants, capital reserves (recycled depreciation through the Major Repairs Reserve) and revenue; and also the amount to be financed through borrowing.

Table 2 – Summary of the capital programme funding (Prudential Indicator 2)

Financing of capital expenditure £'000	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital receipts	3,692	27,070	5,221	7,216	7,546
Capital grants	5,441	10,554	3,265	1,220	1,220
Capital reserves	13,553	14,925	14,238	14,111	14,012
Revenue	11,049	20,836	11,641	6,278	8,944
Total of immediate funding	**33,735**	**73,385**	**34,365**	**28,825**	**31,722**
Net financing need for the year	**0**	**61,142**	**40,000**	**11,510**	**12,040**
Total	**33,735**	**134,527**	**74,365**	**40,335**	**43,762**

20. The above financing need excludes other long term liabilities, i.e. finance leases which include an amount in the lease charge to repay borrowing.

The council's borrowing need (the Capital Financing Requirement)

21. The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's indebtedness and so it's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

22. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used to the Council's General Fund revenue budget.

23. The CFR includes any other long-term liabilities (e.g. PFI schemes and finance leases). Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility by the finance lease provider and so the council is not required to separately borrow for these schemes. The council has a finance lease and the outstanding balance at the end of 2017/18 will be £1.099m which is included within the HRA CFR total.

24. The CFR projections are shown below in table 3:

Table 3 – CFR projections (Prudential Indicator 3)

£'000	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement at year end					
CFR – General fund	33,085	93,900	133,555	144,701	156,358
CFR – Housing	194,788	187,698	185,602	185,501	185,393
Total CFR	**227,873**	**281,597**	**319,157**	**330,202**	**341,751**
Movement in CFR	**(12,034)**	**53,725**	**37,559**	**11,045**	**11,549**

Table 4 Analysis of the movement in CFR (Prudential Indicator 4)

£'000	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Movement in CFR represented by					
Loan repayments	(10,750)	(7,000)	(2,000)	-	-
Net financing need for the year (above)	-	61,142	40,000	11,510	12,040
Less MRP/VRP and other financing movements	(1,284)	(417)	(441)	(465)	(491)
Movement in CFR	**(12,034)**	**53,725**	**37,559**	**11,045**	**11,549**

Note: The CFR will include the balance of finance leases and the MRP will include finance lease annual principal payment.

Core funds and expected investment balances

25. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 5 – Summary of the council's resources

Year End Resources £'000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Fund balances / reserves	53,303	43,364	36,985	21,703	19,486
Capital receipts	26,554	15,897	16,023	16,313	14,756
Provisions	2,553	2,553	2,553	2,553	2,553
Other	771	-	-	-	-
Total core funds	**83,181**	**61,814**	**55,561**	**40,569**	**36,795**
Working capital*	19,898	17,000	17,000	17,000	17,000
Total funds	103,079	78,814	72,561	57,569	53,795
Amount funding (under)/over borrowing**	(17,779)	(17,451)	(17,107)	(16,742)	(16,359)
Available for investment	**(85,300)**	**(61,363)**	**(55,454)**	**(40,827)**	**(37,436)**

Borrowing

26. The capital expenditure plans set out in Table 1 paragraph 17 provide details of the service activity of the council. The treasury management function ensures that the council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

27. The council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.

Table 6 – Estimates of the council's external debt, CFR and under borrowing position (Prudential Indicator 5)

£'000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt					
Debt at 1 April	219,655	208,905	263,047	301,047	312,557
Expected change in Debt	(10,750)	54,142	38,000	11,510	12,040
Other long-term liabilities (OLTL)	1,274	1,189	1,099	1,003	902
Expected change in OLTL	(85)	(90)	(96)	(101)	(107)
Actual gross debt at 31 March	**210,094**	**264,146**	**302,050**	**313,459**	**325,392**
Capital Financing Requirement	**227,873**	**281,597**	**319,157**	**330,202**	**341,751**
Under / (over) borrowing	**17,779**	**17,451**	**17,107**	**16,742**	**16,359**

* Other long-term liabilities are any liabilities that are outstanding under credit arrangements and are outstanding for periods in excess of 12 months e.g. finance leases and PFI schemes.

28. The table above shows that both the debt and the CFR increase significantly between 2017/18 and 2020/21. This is due to the proposed borrowing that will be taken to on-lend to the council's company NRL (Norwich Regeneration Limited) and the financing of commercial property acquisitions.

29. Within the prudential indicators there are a number of key indicators to ensure that the council operates its activities within well-defined limits. One of these is that the council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

30. The chief finance officer reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

Treasury Indicators: limits to borrowing activity

31. Within the prudential indicators there are a number of key indicators to ensure the council operates its activities within well-defined limits.

32. For the first of these the council needs to ensure that its total gross borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.

Table 7 – Estimates of the council's total gross borrowing does not exceed the CFR (Prudential Indicator 6)

£'000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Gross Borrowing	210,094	264,146	302,050	313,459	325,392
Capital Financing Requirement	227,873	281,597	319,157	330,202	341,751
Gross borrowing is below CFR	**(17,779)**	**(17,451)**	**(17,107)**	**(16,742)**	**(16,359)**

33. The chief finance officer reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

34. A further two key prudential indicators control or anticipate the overall level of borrowing, these are:

35. **The operational boundary -** this is the limit beyond which external debt is not normally expected to exceed. The limit may be exceeded but if it is being exceeded on a regular basis then it would act as a trigger to review what is happening with the borrowing. In most cases, the operational boundary would be a similar figure to the CFR, but may be lower or higher depending on the

levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 8 – Operational boundary (Prudential Indicator 7)

Operational boundary £'000	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Operational Boundary upper limit for debt	280,000	315,000	325,000	335,000
Other long term liabilities	1,576	1,600	1,600	1,600
Total	**281,576**	**316,600**	**326,600**	**336,600**

36. **The authorised limit for external debt.** - A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the council. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. The proposed authorised limit is shown in table x below:

Table 9 – Authorised Limit (Prudential Indicator 8)

Authorised Limit £'000	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Authorised limit upper limit for debt	290,000	335,000	345,000	360,000
Other long term liabilities	1,576	1,600	1,600	1,600
Total	**291,576**	**336,600**	**346,600**	**361,600**

37. The authorised limit has been set at a level that allows for borrowing that council are being asked to approve as part of the capital programme, but it also incorporates anticipated borrowing that may be required for potential schemes that still require a business case to be drawn up and then approved. Examples include the redevelopment of the airport industrial estate and the development of various sites within Norwich.

38. Separately, the Council is also limited to a maximum HRA CFR (which equals the HRA Debt Cap) through the HRA self-financing regime. This actual limit is currently under the HRA Debt Cap is shown below in table 10:

Table 10 – Housing Revenue Account Debt Cap and Headroom

HRA Debt Limit £'000	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
HRA Debt Cap	236,989	236,989	236,989	236,989
HRA CFR	182,689	180,593	180,491	180,384
HRA headroom	54,300	56,396	56,498	56,605

Affordability Prudential Indicators

39. The 8 statutory indicators above cover the overall capital and control of borrowing, but in addition, within this framework, there are further indicators that assess the affordability of the capital investment plans. These indicators provide an indication of the impact of the capital investment plans on the council's overall finances and these are shown below:

40. Actual and Estimates of the Ratio of Financing Costs to Net Revenue Stream (Indicators 9 & 10) - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget.

Table 11– Ratio of Financing Costs to Net Revenue Stream (Prudential Indicators 9 & 10)

	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Financing costs as a percentage of net revenue stream *					
General fund	1.57%	5.11%	0.59%	(1.12%)	(2.57%)
HRA	37.01%	37.03%	37.92%	38.78%	38.47%

* Where the figure appears as a negative percentage this is the contribution that the capital investments are making to the General Fund as a percentage of the net revenue stream

41. The General Fund financing costs increase in 2017/18 but then reduce in the years going forward. This is due to the anticipated increase in borrowing required to fund the commercial property acquisition and the on-lending to NRL. The table shows that in 2019/20 and 2020/21 the rental returns and investment income from the commercial acquisitions and on-lending to NRL are making a contribution to the General Fund which exceeds the financing costs.

42. The HRA financing costs vary marginally year on year. This reflects minor variations year on year in the amounts used in the calculations e.g. reductions in the HRA balances which decrease year on year, fluctuations in the rental income. As there is currently no planned borrowing to fund the capital programme this has no impact on the financing costs over the four year period.

43. Estimates of the incremental impact of capital investment decisions on the Council Tax and Housing Rent Levels (Indicators 11 & 12) – These indicators identify the revenue costs associated with proposed changes to the three year capital programme recommended in the budget report compared to the council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support, which are not published over a three year period.

Table 12 Estimates of the incremental impact of capital investment decisions on the Council Tax and Housing Rent Levels (Prudential Indicators 11 & 12)

Estimates of incremental impact of capital investment decisions on council tax & housing rents	2018/19	2019/20	2020/21
	Estimate	Estimate	Estimate
General fund (Prudential Indicator 11) - Impact per property p.a.	£1.19	(£13.61)	(£26.06)
HRA (Prudential Indicator 12) - Impact on rent per week	£0.18	£0.13	£0.15

44. In table 12 above the General Fund indicator shows the impact on Council Tax of varying the capital programme from the previous year's approved programme, if everything else remained constant. The 2018/19 indicator shows £1.19 more of the Band D Council Tax will be used to fund the new programme in 2018/19. In subsequent years the additional income generated from on-lending to NRL and new rental income from commercial property acquisitions exceeds the additional cost of borrowing. This results in £13.61 and £26.06 less of the Band D Council Tax being used to fund the new programme in 2019/20 and 2020/21 respectively.
45. Estimates of the incremental impact of capital investment decisions on Housing Rent Levels are shown in the table 12 above. This indicator is similar to the Council Tax calculation. It shows the trend in the cost of proposed changes in the three year housing capital programme recommended in the MTFS 2018-23 compared to the council's existing commitments and current plans, expressed as a change in weekly rent levels.
46. This Indicator shows that the revenue impact of the change in proposed housing investment programme has a marginal impact as the capital investment programme remains fairly static year on year. These changes will already be contained within the budgeted rent increases in the HRA Business Plan.

Public Finances and the national economic context

47. A summary of the key influencing economic factors, as at the time of writing this report (January 2018), is given below:

Bank Interest Rate: In November 2017 the Bank of England's Monetary Policy Committee (MPC) voted by a majority of 7–2 to increase the Bank Rate by 0.25% to 0.5%, the first increase since July 2007. As things stand, the MPC is expecting two further quarter-point increases in interest rates by the turn of the decade, which would then leave the rate at 1%. *Source: Bank of England*
Inflation: The headline inflation figure, CPI (Consumer Price Index), rose to a five and a half year high of 3% in September and remains at this level. Food and transport costs in particular have increased the CPI. National Treasury's target rate is 2%. The Bank of England predicts a gradual fall in the inflation rate which may reach 2% in 2020.

Source: Bank of England
GDP Growth: The Office for Budget Responsibility (OBR) now expects to see slower GDP growth over the forecast period, mainly caused by the under-performance of productivity in the UK economy. It has revised down its forecast for GDP growth by 0.5 percentage points to 1.5% in 2017, with growth slowing in 2018 and 2019, before rising to 1.6% in 2022. The economic impact of the UK's departure from the European Union however remains uncertain. *Source: Autumn Budget 2017 and Office for Budget Responsibility*
Unemployment Rate and Average Earnings: The UK unemployment rate remains at 4.3% (1.42m individuals) in November 2017 its lowest rate since 1975 - and down from 4.8% a year earlier. Average earnings, excluding bonuses, rose 2.2% in the three months to September 2017, compared with a year ago, but this is a decrease of 0.5% in real terms when accounting for inflation. *Source: Office for National Statistics*
Public Sector Finances: The reductions in future GDP growth have knock-on effects for both public sector net borrowing and for future public sector expenditure as lessened economic growth equates to a reduced tax take. Public sector net borrowing is now forecast to fall over the next four years to some £30bn in 2021/22, instead of the £20bn forecast in the Spring 2017 Budget Statement (and contrasted with the £10bn surplus forecast for 2019/20 in the Chancellor's 2016 Budget Statement). The government's policy had been that after the four year funding settlement finishes in 2020/21, public sector funding would increase in line with inflation during the period of the next spending review (i.e. at about 2%). Lower GDP growth is likely to result in lower increases in public spending. Whilst revised targets are not published yet, and possibly are not likely to be until there is more formal planning for the next spending review, CIPFA warns that the overall increase in public sector funding post 2020/21 could be 1.5% rather than 2%. ***Source: Office for Budget Responsibility and CIPFA***

48. The council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the council to formulate a view on interest rates. Appendix 3 gives their long term view on UK interest rates and the economic forecast.

Borrowing strategy

49. The council is currently maintaining an under-borrowed position. This means that the capital borrowing need (CFR), has not been fully funded with loan debt as cash supporting the council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

50. Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. In accordance with the Financial Regulations, paragraph 38 which delegates all executive decisions on borrowing, investment or financing to the chief finance officer, (who is required to act in accordance with CIPFA's code of practice for treasury management in the public services) the chief finance officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the UK and USA, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- Any decisions will be reported to Cabinet at the next available opportunity.

Treasury indicators for Debt

51. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- **Upper limits on fixed interest rate exposure (Indicator 13)**. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- **Upper limits on variable interest rate exposure (Indicator 14)**. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- **Maturity structure of borrowing (Indicator 15)**. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits

52. Table 10 below shows what the upper limits are for fixed rate and variable rate interest rate borrowing and investments along with the maturity structure for borrowing.

Table 10 – Upper limits on fixed interest rate exposure (Prudential Indicator 13), upper limits on variable interest rate exposure (Prudential Indicator 14) and maturity structure of borrowing (Prudential Indicator 15)

£m	**2018/19**	**2019/20**	**2020/21**
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates: Debt only Investments only	 100% 100%	 100% 100%	 100% 100%
Limits on variable interest rates: Debt only Investments only	 20% 20%	 20% 20%	 20% 20%
Maturity structure of fixed interest rate borrowing 2018/19			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	30%
5 years to 10 years		0%	50%
10 years and above		0%	95%

Policy on borrowing in advance of need

53. The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the council can ensure the security of such funds.

54. The Council has some flexibility to borrow funds this year for use in future years. The chief finance officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the chief finance officer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Borrowing in advance will be made within the constraints that:
    - It will be limited to no more than 75% of the expected increase in borrowing need (CFR) over the three year planning period; and
    - Would not look to borrow more than 36 months in advance of need

55. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

56. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

57. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

58. All rescheduling will be reported to the Cabinet at the earliest meeting following its action. However it is extremely unlikely that any debt rescheduling will take place in the near future as the difference between the interest rates on existing loans and the current low levels of interest rates is too large and would result in a premium being due which would be too costly.

UK Municipal Bond Agency (MBA)

59. It is possible that the MBA will be offering loans to local authorities in the future. The MBA hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The council may make use of this new source of borrowing as and when appropriate. On 11 October 2017 Cabinet agreed that the council could enter into borrowing framework agreement to allow them to borrow from the UK MBA.

MINIMUM REVENUE PROVISION POLICY STATEMENT

60. The council is required to pay off an element of the accumulated General Fund borrowing each year through a revenue charge (the MRP), and is also allowed to undertake additional voluntary payments (VRP).

61. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

62. Repayments included in annual PFI or finance leases are applied as MRP.

63. CLG Regulations have been issued which require full council to approve an MRP Statement in advance of each year. A variety of options are provided so long as there is a prudent provision.

64. At the meeting on 17 January 2017 Cabinet approved a revised MRP policy to take effect in the financial year 2017/18 and onwards. The changes to the Minimum Revenue Provision (MRP) policy have resulted in an overpayment of £7.4m having been made in MRP costs dating back from 2007/08 to date. This amount will be used to reduce existing MRP budgets for the financial year 2017/18 onwards over a period of 40 years. Having looked at several

methodologies for crediting this overpayment back to the General Fund revenue budget the methodology to be used is credit the £7.4m back to the General Fund over 40 years in equal instalments of approximately £184,000 per annum. This is an appropriate method as it provides certainty as to the amount that will be credited each year and it spreads the credit evenly over the lifetime of the MRP that it relates to.

65. Council is recommended to approve the MRP Policy Statement as detailed in Appendix 1. This is the same statement that was approved by Cabinet as part of the mid-year treasury management review report on 17 January 2018

ANNUAL INVESTMENT STRATEGY

Investment policy

66. The council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The council's investment priorities will be security first, liquidity second, and then return.

67. In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the council applies minimum acceptable credit criteria to generate a list of highly creditworthy counterparties which also enables diversification and thus minimises concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

68. Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this, the council will engage with its advisors to watch the market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

69. Other information sources used will include the financial press, share price and other such information relating to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

70. Investment instruments identified for use in the financial year are listed in Appendix 2 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the council's treasury management practices – schedules.

Creditworthiness policy

71. The primary principle governing the council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the council's prudential indicators covering the maximum principal sums invested.

72. The chief finance officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the council may use, rather than defining what types of investment instruments are to be used.

73. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services, the council's treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum council criteria will be suspended from use, with all others being reviewed in light of market conditions.

74. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

- Banks 1 - good credit quality **–** the council will only use banks which:
    - are UK banks; and/or
    - are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA
    - and have, as a minimum, the following Fitch, Moody's and Standard Poors credit ratings (where rated):
- Short term - F1, P1, A1
- Long term – A, A2, A
- Viability / financial strength – bbb+ (Fitch / Moody's only)
- Support – 5(Fitch only)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The council will use these only where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies The council will *use* all societies which:
    - meet the ratings for banks outlined above
    - have assets in excess of £2bn
    - or meet both criteria.
- Money market funds – *AAA*
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc.
- Supranational institutions

Ethical Investment

75. The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's mission and values. This would include, inter alia, avoiding direct investment in institutions with material links to:
- human rights abuse (e.g. child labour, political oppression)
- environmentally harmful activities (e.g. pollution, destruction of habitat, fossil fuels)
- socially harmful activities (e.g. tobacco, gambling)

76. This applies to direct investment only. The Council's normal money market activity would usually be with financial institutions which may have unknown indirect links with companies which the Council will be unable to monitor. However, where known links are publicly available the Council will not knowingly invest.

Use of additional information other than credit ratings

77. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments

78. The time and monetary limits for institutions on the Council's counterparty list are shown in table 10 below (these will cover both specified and non-specified investments):

Table 10 - Time and monetary limits applying to the council's investments

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	AA	£15m	364 days
Banks 1 lower quality	AA	£5m	364 days
Banks 2 – part nationalised	N/A	£15m	3 years
Limit 3 category – council's banker (if doesn't meet Banks 1 criteria)	A-	£5m	3 months
Building Societies	Asset worth at least £2bn	£10m	364 days
DMADF	AAA	Unlimited	6 months
Local authorities (LA)	N/A	£10m per LA	5 years
Money Market Funds	AAA	£5m per fund £25m overall limit	Liquid
CCLA Local Authorities' Property Fund		£10m	Minimum of 5 years

Country limits

79. Due care will be taken to consider the country, group and sector exposure of the council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:
    - no more than 30% will be placed with any non-UK country at any time and would always be sterling investments
    - limits in place above will apply to a group of companies
    - sector limits will be monitored regularly for appropriateness

Strategy for investment of funds

80. The council does not use external fund managers to manage any funds. All funds are invested by the in-house treasury management team. Investments are made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations

81. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are for:

Table 11 – Forecast interest rates provided by Link Asset Services

2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	Later years
0.40%	0.60%	0.90%	1.25%	1.50%	1.75%	2.00%	2.75%

82. The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit

83. These indicators specify the limit for the total principal funds invested for greater than 365 days. These limits are set with regard to the council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

84. The proposed treasury indicator and limit is set out in table 13 below

Table 12 – Time and value limits for principal sums invested (Prudential Indicator 16)

Maximum principal sums invested > 364 days	2018/19	2019/20	2020/21
Principal sums invested > 364 days	£5m	£5m	£5m

85. For its cashflow generated balances, the council will use its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Investment risk benchmarking

86. These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

87. **Security** - The council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is 0.041% historic risk of default when compared to the whole portfolio.

88. **Liquidity** – in respect of this area the Council seeks to maintain:
    - Bank overdraft – zero balance
    - Liquid short term deposits of at least £1m available with a week's notice.
    - Weighted average life benchmark is expected to be 0.22 years, with a maximum of 1.00 year.

89. **Yield -** local measures of yield benchmarks are:
    - Investments – internal returns above the 7 day LIBID rate

90. End of year investment report - At the end of the financial year, the council will report on its investment activity as part of its Annual Treasury Report.

Treasury Management Practices

91. The Council adopted the CIPFA Code of Practice on Treasury Management (revised 2011) on 2nd March 2010. At this time the Treasury Management Policy Statement was also adopted. The Treasury Management Policy and Practices (TMP's) are updated annually to reflect the Treasury Management Strategy approved by council and to reflect any changes in staffing structures or working practices of the treasury function.

92. A copy of the Treasury Management Practices are available from Financial Services should members require further information. TMP 1 – Credit and counterparty Risk Management has been included as Appendix 3 and gives details of investment instruments identified for use in the financial year.

Adoption of the CIPFA Treasury Management in the Public Services: Code of Practice Cross Sectoral Guidance Notes (Indicator 17).

93. Norwich City Council has adopted the Code has been adopted and is applied in managing Treasury Management activities.

Treasury Management Advisers

94. The Council uses Link Asset Services as its treasury management consultants. The company provides a range of services which include:

    - Technical support on treasury matters, capital finance issues and the drafting of Member reports;
    - Economic and interest rate analysis;
    - Debt rescheduling advice surrounding the existing portfolio;
    - Credit ratings/market information service comprising the three main credit rating agencies.

95. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

Integrated impact assessment

NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with the completion of the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	14 February 2018
Director / Head of service	Chief finance officer
Report subject:	Treasury /Management Strategy 2018/19
Date assessed:	January 2018
Description:	The report outlines the council’s prudential indicators for 2018/19 through to 2020/21 and sets out the expected treasury operations for this period.

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	This report has no direct financial consequences however it does set the guidelines for how the council manages its borrowing and investment resources.
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

Minimum Revenue Provision (MRP) Policy

1. The council is required to pay off an element of the accumulated General Fund borrowing each year through a revenue charge (the MRP), and is also allowed to undertake additional voluntary payments (VRP).
2. CLG Regulations have been issued which require full council to approve an MRP Statement in advance of each year. A variety of options are provided so long as there is a prudent provision.
3. Council is recommended to approve the following MRP Statement:

For capital expenditure incurred:

(A) Before 1st April 2008 or which in the future will be Supported Capital Expenditure including the Adjustment A, the MRP policy will be to charge MRP on a 2% annuity basis so that there is provision for the full repayment of debt over 50 years;

(B) From 1st April 2008 for all unsupported borrowing (excluding finance leases) the MRP policy will be to charge MRP on a 2% annuity basis so that there is provision for the full repayment of debt over 50 years; Asset life is deemed to begin once the asset becomes operational. MRP will commence from the financial year following the one in which the asset becomes operational.

(C) MRP in respect of unsupported borrowing taken to meet expenditure, which is treated as capital expenditure by virtue of either a capitalisation direction or regulations, will be determined in accordance with the asset life method as recommended by the statutory guidance.

(D) Expenditure in respect of the Local Authority Mortgage Scheme will not be subject to a minimum revenue provision as this is a temporary arrangement and the funds will be returned in full.

(E) Expenditure in respect of loans made to the council's wholly owned companies will not be subject to a minimum revenue provision as the council will have undertaken sufficient due diligence to expect these loans will be repaid in full to the council by a capital receipt either during the loan agreement term or at the end of the agreement. Therefore the council considers that it can take a prudent view that the debt will be repaid in full at the end of the loan agreement (or during if it is an instalment loan), so MRP in addition to the loan debt repayments is not necessary.

This is subject to the following details:

- An average asset life for each project will normally be used. There will not be separate MRP schedules for the components of a building (e.g. plant, roof etc.). Asset life will be determined by the Chief Finance Officer. A standard schedule of asset lives will generally be used (as stated in the Statement of Accounts accounting policies).
- MRP will commence in the year following the year in which capital expenditure financed from borrowing is incurred, except for single assets

when expenditure is being financed from borrowing the MRP will be deferred until the year after the asset becomes operational.

- Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, at the discretion of the Chief Finance Officer.
- There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. Transitional arrangements with respect to depreciation, revaluation and impairments; put in place at 1 April 2012 were due to expire on 31 March 2017. However the Item 8 determination released on 24 January 2017 has extended indefinitely the ability to charge depreciation, revaluations and impairments to the HRA but reverse in the Movement in Reserves Statement.
- Repayments included in annual finance leases are excluded from MRP as they are deemed to be a proxy for MRP.

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This council adopted the Code on 2 March 2010 and will apply its principles to all investment activity. In accordance with the Code, the chief finance officer has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the council will use. These are high security (i.e. high credit rating, although this is defined by the council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1) The UK Government (such as the Debt Management Account Deposit Facility, UK treasury bills or a gilt with less than one year to maturity).
2) Supranational bonds of less than one year's duration.
3) A local authority, parish council or community council.
4) Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this

covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.

5) A body that is considered of a high credit quality (such as a bank or building society For category 5 this covers bodies with a minimum Short Term rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies .

To be defined as a Specified Investment the above instruments will have these features common to all:

- Be denominated in Sterling,
- Of not more than 1 year maturity,
- Of longer than 1 year maturity but the Council has the right to be repaid within 12 months,
- For instruments numbered 5 to 7 these must be with institutions of high credit quality.

Non-specified investments –are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with the following:

	Non Specified Investment Category	Limit (£ or %)
a.	**Supranational bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. National Rail, the Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£15m £15m
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£15m
c.	**The Council's own banker** if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£5m
d.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The council may use such building societies which have a minimum asset size of £2bn, but will restrict these type of investments to 364 days.	£10m or 1% of assets

e.	Any **bank or building society** that has a minimum long term credit rating of A+/A, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum limit of 100% so long as no more than 25% of investments have maturities of one year or more.
f.	Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to having a minimum asset size of £250m and a restriction on the investment amount of 1% of its assets size.	£10m for a period of no longer than 3 months
g.	**Certificates of Deposits or corporate bonds** with banks or building societies.	£5m
h.	**Money Market Funds**	£5m
i.	**Pooled Property Funds** The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The exception to this is an investment in the CCLA Local Authorities Property Fund.	CCLA £5m

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the chief finance officer, and if required new counterparties which meet the criteria will be added to the list.

Prospects for interest rates and the economic outlook

1. This appendix provides further detailed information in addition to the information that can be found at paragraph 34 which covers the public finances and the national economic context. The information below has been provided by Link Asset Services.

Table 1 – Forecast interest rates provided by Link Asset Services

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

2. As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November 2017. This removed the emergency cut in August 2016 after the EU referendum. The MPC also indicated that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast above includes these Bank Rate increases in in November 2018, November 2019 and August 2020.

3. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Federal Bank has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

4. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Federal bank has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and thus bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

5. From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and

emerging market developments. Such volatility could occur at any time during the forecast period.

6. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

7. The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

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

    - Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
    - Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
    - A resurgence of the Eurozone sovereign debt crisis, possibly in Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
    - Weak capitalisation of some European banks.
    - The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. The new Czech prime minister, Andrej Babis is strongly against EU migrant quotas and refugee policies. This combination could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
    - Rising protectionism under President Trump
    - A sharp Chinese downturn and its impact on emerging market countries

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

    - The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
    - UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
    - The Fed. causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in

the US, which could then spill over into impacting bond yields around the world.

Investment and borrowing rates

10. Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
11. Borrowing interest rates increased sharply after the general election result in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during this financial year. The policy of avoiding new borrowing by using 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
12. There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.