Report to	Cabinet	**Item**
	17 January 2018	
Report of	Chief finance officer (Section 151 Officer)	9
Subject	Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2017/18	

Purpose

This report sets out the Treasury Management performance for the first six months of the financial year to 30 September 2017. This is in accordance with the requirements of the Prudential Code. It also contains proposals to change aspects of the 2017/18 Treasury Management Strategy.

Recommendation

To:

(1) note the report and the treasury activity.

(2) recommend to council:

a) approval of the revised authorised limit and operational boundary prudential indicators for the current financial year 2017/18.
b) approval of the revised MRP policy to take effect this financial year onwards.

Corporate and service priorities

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

Financial implications

The proposed changes to the Minimum Revenue Provision (MRP) policy will result in an overpayment of £7.4m having been made in MRP costs dating back from 2007/08 to date. This amount can be used to reduce existing MRP budgets from this financial year onwards over a period of some 20 to 40 years depending on the methodology employed to credit this sum back to the General Fund revenue budget. The resultant re-profiling of the future MRP budget will be brought to council for approval as part of the budget and Treasury Management Strategy (TMS) reports in February 2018.

Ward/s: All wards

Cabinet member: Councillor Kendrick - resources

Contact officers

Karen Watling, chief finance officer	01603 212440
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Background documents

None

Report

Background

1. The prudential system for capital expenditure is now well established. One of the requirements of the Prudential Code is to ensure adequate monitoring of capital expenditure plans and the treasury management response to these plans. This report fulfils that requirement and includes a review of compliance, as at 30 September 2017, with the 2017/18 Treasury and Prudential Limits and the Prudential Indicators approved by Council on 21 February 2017.

2. This council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code. This requires that the prime objective of treasury management activity is the effective management of risk, and that borrowing activities are undertaken on a prudent, affordable and sustainable basis.

3. Following council's decision to increase the 2017/18 capital programme by £26.647m on 28 November 2017, coupled with an internal review of the council's Minimum Revenue Provision (MRP) policy, this report also includes proposals to make changes to the 2017/18 prudential indicators and MRP policy.

Investment Strategy

4. The Treasury Management Strategy Statement (TMSS) for 2017/18 which includes the Annual Investment Strategy was approved by the council on 21 February 2017. It sets out the Council's investment priorities as being:
    - Security of capital;
    - Liquidity; and
    - Yield

5. No policy changes are being proposed to the investment strategy.

6. The council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 12 months, with highly credit rated financial institutions, using Link Asset Services' suggested creditworthiness approach.

7. The council held £78.350m of investments as at 30 September 2017. The following table shows the movement in investments for the first six months of the year.

Investments	Actual 31 March 2017	Investments	Maturities	Actual 30 September 2017
	£'000	**£'000**	**£'000**	**£'000**
Short term				-
Banks	28,000	8,000	(15,000)	21,000
Building Societies	27,400	159,415	(146,965)	39,850
Cash Equivalents				-
Banks	10,660	24,125	(24,785)	10,000
Local Authorities	7,500	9,500	(11,000)	6,000
Money Market Funds	-	1,500		1,500
Total	**73,560**	**202,540**	**(197,750)**	**78,350**

8. The council's investment return for the first six months of 2017/18 is £271,503. The full year budget is £400,000.

9. During the second half of the year it is anticipated that the level of investments held by the council will decrease. This is because the additional funding for on-lending to Norwich Regeneration Limited (NRL) and for commercial property acquisition (approved at council on 28 November 2017) will both be funded by using internal balances (cash) instead of external borrowing on a temporary basis. Although this will have an adverse impact on the level of investment income that can be generated during the second half of the year, this is more than compensated for by the new net income returns generated from both schemes. For example, the income returns for external financial investments are currently averaging 0.64% whereas the net returns from commercial property acquisitions are averaging 3.8%.

10. The chief financial officer confirms that all investment transactions undertaken during the first six months of 2017/18 were within the approved limits as laid out in the Annual Investment Strategy.

External Borrowing

11. The table below shows the council has actual external borrowing of £209m most of which relates the Housing Revenue Account. There has been no new borrowing to date in this financial year.

Borrowing Long Term	TMSS	Actual 01-Apr-17	Actual 30-Sep-17
	£'000	**£'000**	**£'000**
Public Works Loan Board	203,680	203,106	203,106
Money Market	5,000	5,000	5,000
3% Stock (Perpetually irredeemable)	499	499	499
Corporate Bonds and External Mortgages	74	74	74
Finance Leases	1,003	1,189	1,189
Total	210,256	209,868	209,868

Debt Rescheduling

12. No debt rescheduling was undertaken during the first six months of 2017/18. None will be undertaken during the remainder of the financial year.

Prudential Indicators

13. This following sections of this report provide an update on:

- Changes to the council's capital expenditure plans;
- How capital expenditure is being financed;
- The impact of these changes on the prudential indicators and the underlying need to borrow.

Capital Expenditure

14. The table below shows the 2017/18 original and revised capital programme, the latter agreed by council on 28 November.

	2017/18 Original	2017/18 Revised
	£'000	**£'000**
General Fund	35,075	67,489
HRA	51,281	47,094
Capital Expenditure	86,356	114,583
Financed by:		
Capital receipts	16,246	12,382
Capital grant and contributions	8,897	10,713
Capital reserves	6,925	0
Major Repairs Reserve	0	13,871
Revenue	22,366	19,927
Total Resources	54,434	56,893
Net borrowing need for the year	**31,922**	**57,690**

15. On 28 November 2017 council agreed an increase in the 2017/18 General Fund capital programme for on-lending to NRL and for commercial property acquisition.

16. In addition, the Neighbourhood Housing programme within the HRA capital budget has been re-profiled resulting in a reduction in the budget.

Financing of the Capital Programme

17. The table in paragraph 14 above shows how the revised capital programme will be financed and shows that the net borrowing need for the year has

increased from that anticipated in the TMS agreed by council in February 2017. The consequence of this is that it will also increase the council's Capital Financing Requirement (CFR).

18. The principal changes in financing the capital programme are a reduction in the use of capital receipts, a reduction in the use of HRA revenue contributions which are replaced with the use of the Major Repairs reserve, and the increased need to borrow (either externally or internally from cash) to fund the on-lending to NRL and the commercial property acquisitions .

The Capital Financing Requirement

19. The first table below shows the council's Capital Financing Requirement (CFR), which is the council's underlying need to borrow for a capital purpose. The second table compares the original and revised expected actual debt position over the year with the CFR and gives the over/(under) borrowing position.

	2017/18 Original Estimate	**2017/18 Revised Estimate as at 30.09.17**
	£'000	**£'000**
General Fund CFR	64,539	89,432
HRA CFR	217,665	205,624
Total CFR	282,204	295,056
Movement in CFR	31,620	57,351
Movement in CFR represented by:		
Borrowing need for the year	31,922	57,690
Less MRP	(302)	(339)
Movement in CFR	31,620	57,351

	2017/18 Original Estimate	**2017/18 Revised Estimate as at 30.09.17**
	£'000	**£'000**
Gross borrowing	215,856	266,085
CFR	282,204	295,056
Over/(Under) Borrowing	(66,348)	(28,971)

Prudential Indicators relating to Borrowing Activity

20. Given the revisions to the 2017/18 capital programme and its financing two changes are being proposed, namely:

21. **An increase in the Authorised Limit** – This represents the limit beyond which borrowing is prohibited, and needs to be set and agreed by council. It is the maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

	2017/18 Original Estimate	**2017/18 Revised Estimate as at 30.09.17**
Authorised Limit for external debt	**£'000**	**£'000**
Borrowing	253,707	290,000
Other long term liabilities	1,576	1,576
Total	255,283	291,576

22. **An increase in the Operational Boundary** – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. CIPFA anticipate that this should act as an indicator to ensure the authorised limit is not breached.

	2017/18 Original Estimate	**2017/18 Revised Estimate as at 30.09.17**
Operational boundary for external debt	**£'000**	**£'000**
Borrowing	253,107	270,000
Other long term liabilities	1,576	1,576
Total	254,683	271,576

Other Prudential Indicators

23. This section of the report gives details on the updated position on the remaining prudential indicators agreed by Council in February 2017.

Borrowing Activity

24. Long-term fixed interest rates are currently low and the Bank of England expects them to rise by a further 0.5% over the three-year treasury management planning period. The Chief Finance Officer, under delegated authority, will undertake the most appropriate form of borrowing depending on the prevailing interest rates at the time and taking into account the associated risks e.g. counterparty risk and risk of interest rate increases.

25. Opportunities for debt restructuring will be continually monitored. Action will be taken when the chief finance officer feels it is most advantageous.

Investment Performance

26. The objectives of the council's investment strategy are firstly the safeguarding of the repayment of the principal and interest of its investments, and secondly ensuring adequate liquidity. The investment return is the third objective. The current investment climate is one of over-riding risk consideration i.e. that of counterparty security risk. As a result of this underlying concern, officers continue to implement an operational investment strategy, which adheres to the controls in place in the approved investment strategy.

27. The council held £78.350m of investments at 30th September 2017 and the investment profile is shown in the table in paragraph 7 above.

Risk Benchmarking

28. The 2017/18 Investment Strategy for financial investments includes the following benchmarks for liquidity and security.

29. Liquidity – The council has no formal overdraft facility and seeks to maintain liquid short-term deposits of at least £1 million available with a week's notice.

30. The weighted average life (WAL) of investments for the year was expected to be 0.45 years (164 days). At 30 September 2017 the Council held liquid short term deposits of £78.350 million and the WAL of the investment portfolio was 0.28 years (103 days). The reduction in the WAL of the investment portfolio is due to most of the investments over 1 year in duration maturing and being replaced with shorter term investments.

31. The chief finance officer can report that liquidity arrangements were adequate during the year to date.

32. Security – The council's maximum security risk benchmark for the portfolio as at 30 September 2017 is 0.066%, which equates to a potential loss of £0.052 million on an investment portfolio of £78.350m.

33. This is slightly higher than the anticipated maximum risk of 0.05% in the Treasury Management Strategy (i.e. a potential loss of £0.039m) but still represents a very low risk investment portfolio. The current investment portfolio carries a very much lower level of risk than Link's model portfolio and other local authorities within our benchmarking group.

34. The target set within the 2017/18 Strategy is that a minimum of 75% of the portfolio must be held in low risk specified investments. At 30th September 2017, 100% of the investment portfolio was held in low risk specified investments.

35. The chief finance officer can report that the investment portfolio was maintained within this overall benchmark during the year to date.

Proposed Changes to the Minimum Revenue Provision (MRP) policy statement

36. The council is required to approve an MRP Policy Statement prior to each financial year. Council approved the current statement as part of the overall Treasury Management Strategy on 21 February 2017. MRP is a charge to the council's General Fund budget, and hence a cost to council tax payers, designed to set aside a prudent sum of money to repay borrowing needed to fund the capital programme. The policy sets out how MRP charges will be calculated.

37. During 2003 the Department of Communities and Local Government issued statutory guidance on the future options available for calculating MRP charges from 2008 onwards (Regulation 28 of the 2003 Regulations). The council must have regard to this guidance. The guidance is not prescriptive and makes it clear that councils can follow an alternative approach, provided they still make a prudent provision. The broad aim of a 'prudent provision' is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits to service delivery.

38. In 2015/16 in light of this guidance, this council, along with many others across the country, undertook a review of its MRP policy to establish whether the existing approach was prudent and fair. Following this review a change in the council's MRP policy was approved by council in February 2016. The new policy was to charge MRP on a 2% annuity basis. This was a change from the method previously applied which was to charge MRP on the 4% reducing balance Regulatory Method.

39. This change was considered to be both more prudent as well as fair as it would:

- Provide a provision to repay borrowing over a 50 year period - rather than the 150+ years it would take using the reducing balance method.
- Promote intergenerational fairness as the previous MRP policy meant that future tax payers could still be paying for assets that would perhaps no longer be in use in 150 years' time.
- Deliver savings to the General Fund revenue budget.

40. This changed policy was applied to the CFR balance from 2015/16 onwards.

41. Ahead of undertaking the mid-year review of the 2017/18 treasury management activity, the MRP policy has been reviewed again because it is now considered that the application of the annuity basis provision can be back-dated and applied from its inception, i.e. apply the annuity basis method of calculation from 2007/08 onwards rather than just from 2015/16 onwards.

42. The rationale for backdating the policy agreed by council in February 2016 is the same as for the original review (see paragraph 39 above) plus upon reflection it is a fairer approach to use.

43. A further change is also proposed within the MRP policy, namely that no MRP charges will be made for borrowing undertaken by the council for the purpose of on-lending to its wholly owned companies. Currently the council has one

such company, Norwich Regeneration Limited (NRL). As shareholder the council will only on-lend if the company's financial model shows that the loan interest charged to the company can be serviced through the on-going income generated by the company and that the loan amounts can be repaid in full 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 the MRP charge in these instances is not necessary.

44. Both the above changes have been explored with our advisors, Link Asset Services as well as our external auditors (Ernst and Young) who have advised on the approach that is being taken.

45. If the proposal is agreed the revised MRP charges will apply for this current year 2017/18 onwards as well as being included in the 2018/19 Treasury Management Strategy proposed to council in February 2018.

46. Council is recommended to approve the revised MRP Statement**,** the formal wording for which can be found at Appendix 1.

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:	13/12/17
Director / Head of service	Karen Watling
Report subject:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2017/18
Date assessed:	04/12/2017
Description:	This is a mid-year report to inform council on the performance of the treasury management activity for the first 6 months of the year and it includes revisions to the prudential indicators for the authorised and limit and operation boundary. Also the report includes proposals to update the MRP policy.

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The prudential indicators show that for the first 6 months of the year treasury management activity has produced positive results e.g. achieving an investment interest rate above the target.
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**

	Impact			
Risk management	☐	☒	☐	Managing risk is a major part of undertaking the treasury management activity. All the indicators and limits put in place to reduce the level of risk have been adhered to thus reducing the risks to an acceptable level as stated in the Treasury Management Strategy.

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

Appendix 1

Minimum Revenue Provision (MRP) policy 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 an 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.