

Treasury Management Strategy Statement and Investment Strategy 2018/19 to 2020/21



Contents

- 1. Background**
- 2. External Context**
- 3. Local Context**
- 4. Borrowing Strategy**
- 5. Investment Strategy**
- 6. Non-Treasury Investments**
- 7. Treasury Management Indicators**
- 8. Other Items**
- 9. Financial Implications**

Annexes

- A. Economic & Interest Rate Forecast (Section 2.9)**
- B. Existing Investment & Debt Portfolio Position (Section 3.1)**
- C. Prudential indicators**
- D. MRP Statement 2018/19**

1. Background

- 1.1. On 23rd February 2012 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.
- 1.2. In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.
- 1.3. The report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.
- 1.4. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.
- 1.5. **Revised strategy:** In accordance with the CLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of its investment balance.

2. External Context

- 2.1 **Economic background:** The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating a smooth exit from the European Union and agreeing future trading relationships. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.
- 2.2 Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.
- 2.3 In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.
- 2.4 **Credit outlook:** High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

- 2.5 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.
- 2.6 The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.
- 2.7 **Interest rate forecast:** The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- 2.8 Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.
- 2.9 A more detailed economic and interest rate forecast provided by the Authority's treasury management advisor is attached at **Annex A**.
- 2.10 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.45%, which takes into account strategic fund investments, and that short term loans will be borrowed at an average of 0.60%.
- 3. Local Context**
- 3.1 The Authority currently has borrowings of £145m and investments of £23m. This is set out in further detail at **Annex B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.17 Actual £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m	31.3.21 Estimate £m
General Fund CFR	287	347	391	393	403
Less: Other long-term liabilities *	28	(27)	(26)	(24)	-23
Borrowing CFR	259	320	365	369	380
Less: External borrowing **	(116)	(183)	(90)	(83)	(79)
Internal (over) borrowing	143	137	275	286	301
Less: Usable reserves	(88)	(69)	(63)	(58)	(55)
Less: Working capital	(46)	(46)	(46)	(46)	(46)
Investments (or New borrowing)	(9)	(22)	(166)	(182)	(200)

* finance leases and PFI liabilities that form part of the Authority's debt

** shows only loans to which the Authority is committed and excludes optional refinancing

- 3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
- 3.3 The Authority has an increasing CFR due to the capital programme and will therefore be required to borrow up to £ m over the forecast period.
- 3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2018/19.

4. Borrowing Strategy

- 4.1 The Authority currently holds loans of £145m, an increase of £35m on the previous year. PWLB debt is reducing by £6m per year whilst cash flow shortfalls caused by internal borrowing and prepayment of the pension fund deficit is being funded through cheaper short term borrowing. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.
- 4.2 The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.
- 4.3 Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to use both internal resources and to borrow short-term loans instead.
- 4.4 By doing so, the Authority is able to reduce net borrowing costs and reduce overall treasury risk. The benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 4.5 Alternatively, the Authority may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
- 4.6 In addition, the Authority may borrow further short-term loans to cover unexpected or planned temporary cash flow shortages.
- 4.7 The approved sources of long-term and short-term borrowing are:

OFFICIAL

- Public Works Loan Board and any successor body
 - UK local authorities
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - UK public and private sector pension funds (except Cheshire Pension Fund)
 - capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
 - European Investment Bank
 - Salix Finance Ltd energy efficiency loans
- 4.8 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- operating and finance leases
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback
- 4.9 The Authority has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.
- 4.10 **Municipal Bond Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report.
- 4.11 **LOBO's:** The Authority holds £17m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2018/19, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.
- 4.12 **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limits on the maturity structure of borrowing and the net exposure to variable interest rates in the treasury management indicators below.
- 4.13 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

5. Investment Strategy

- 5.1 Although reduced from previous years, the Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £16m and £56m. Levels of around £25m are expected to be maintained in the forthcoming year.
- 5.2 Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 5.3 If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
- 5.4 Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to continue to diversify into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for any longer-term investment. The Authority has some investments in higher yielding asset classes with the remaining surplus cash invested for liquidity purposes in short-term unsecured bank deposits and money market funds.
- 5.5 The Authority may invest its surplus funds with any of the counterparties in table 2 below, subject to the cash and time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks* Unsecured	Banks* Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£6m 5 years	£12m 20 years	£12m 50 years	£6m 20 years	£6m 20 years
AA+	£6m 5 years	£12m 10 years	£12m 25 years	£6m 10 years	£6m 10 years
AA	£6m 4 years	£12m 5 years	£12m 15 years	£6m 5 years	£6m 10 years
AA-	£6m 3 years	£12m 4 years	£12m 10 years	£6m 4 years	£6m 10 years
A+	£6m 2 years	£12m 3 years	£6m 5 years	£6m 3 years	£6m 5 years
A	£6m 13 months	£12m 2 years	£6m 5 years	£6m 2 years	£6m 5 years
A-	£6m 6 months	£12m 13 months	£6m 5 years	£6m 13 months	£6m 5 years
None	£1m 6 months	n/a	£12m 25 years	£100,000 5 years	£6m 5 years
Pooled funds	£12m per fund				

*Banks includes Building Societies

The above limits apply to individual counterparties and represent the maximum amount and maximum duration of any investment per counterparty.

- 5.6 **Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- 5.7 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- 5.8 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
- 5.9 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- 5.10 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £100,000 per company as part of a diversified pool in order to spread the risk widely.
- 5.11 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.
- 5.12 **Pooled Funds:** Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 5.13 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for

withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

- 5.14 **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept to the lowest practical levels per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.
- 5.15 **Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 5.16 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
- 5.17 **Other Information on the Security of Investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 5.18 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.
- 5.19 **Specified Investments:** The CLG Guidance defines specified investments as those:
- denominated in pound sterling,
 - due to be repaid within 12 months of arrangement,
 - not defined as capital expenditure by legislation, and
 - invested with one of:

- the UK Government,
- a UK local authority, parish council or community council, or
- a body or investment scheme of “high credit quality”.

5.20 The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

5.21 **Non-specified Investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£25m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£20m
Total investments (except pooled funds) domiciled in foreign countries rated below AA+	£15m
Total non-specified investments	£60m

5.22 **Investment Limits:** The Authority’s revenue reserves available to cover investment losses are forecast to be £76m on 31st March 2018. In order that no more than 8% of available reserves will be put at risk in the case of a single default, the maximum that will be lent unsecured to any one organisation (other than the UK Government) will be £6m. Secured investments will have a higher limit of £12m per organisation. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment Limits

Type of Counterparty	Cash limit
Any single organisation, except the UK Central Government	£12m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£12m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker’s nominee account	£25m per broker
Foreign countries	£12m per country

Registered Providers	£25m in total
Unsecured investments with Building Societies	£12m in total
Loans to unrated corporates	£12m in total
Money Market Funds	£12m in each (£50m in total)

5.23 **Liquidity management:** The Authority maintains a cash flow forecasting model to determine the maximum period for which funds may prudently be committed. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

6. Non-Treasury Investments

6.1 Although not classed as treasury management activities, the Authority may also purchase property for investment purposes and may also make loans and investments as part of a wider strategy for local economic growth even though these loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

6.2 The Authority's existing non-treasury investments are listed in Annex B.

6.3 Where a local authority holds a non-financial investment, it will normally have a physical asset that can be realised to recoup the capital invested.

7. Treasury Management Indicators

7.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

7.2 **Interest Rate Exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months. All other instruments are classed as variable rate.

7.3 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	60%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	35%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	100%	0%
20 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper limit for loans maturing under 12 months has been increased as short term funding is currently considerably cheaper than alternatives. This will be kept under review as it does increase the risk of higher financing costs in the future.

- 7.4 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Authority’s exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£25m	£15m	£10m

8. Other Items

- 8.1 There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.
- 8.2 **Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities’ use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 8.3 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 8.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
- 8.5 **Investment Advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through regular meetings and periodic tendering for services.
- 8.6 **Investment Training:** The needs of the Authority’s treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by our treasury management advisers, Arlingclose Limited and other relevant providers.
- 8.7 **Investment of Money Borrowed in Advance of Need:** The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is

aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

- 8.8 The total amount borrowed will not exceed the authorised borrowing limit of £425 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

9. Financial Implications

- 9.1 Anticipated investment income in 2018/19 is £360,000, based on an average investment portfolio of £25 million at an interest rate of 1.45%. The budget for debt interest paid in 2018/19 is £4.5 million, based on an average debt portfolio of £200 million at an average interest rate of 2.25%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Annex A - Arlingclose Economic & Interest Rate Forecast

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.
- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	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	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.19
Arlingclose Central Case	0.50													
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.15
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.22
Arlingclose Central Case	0.50													
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.20
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.27
Arlingclose Central Case	0.70	0.70	0.70	0.70	0.80	0.77								
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.26
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.80	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	0.89
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.33
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	1.25	1.25	1.25	1.25	1.25	1.30	1.30	1.35	1.40	1.45	1.50	1.55	1.55	1.36
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.33
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	1.85	1.85	1.85	1.85	1.85	1.90	1.90	1.95	1.95	2.00	2.05	2.05	2.05	1.93
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.38
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	1.70	1.70	1.70	1.70	1.70	1.75	1.80	1.85	1.90	1.95	1.95	1.95	1.95	1.82
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.39

Annex B

Existing Investment & Debt Portfolio Position

	31/12/17 Actual Portfolio £m	31/11/17 Average Rate %
External Borrowing:		
PWLB - Fixed Rate	80	3.96%
PWLB - Variable Rate	0	-
Local Authorities	44	0.47%
LOBO Loans	17	4.63%
Other	4	-
Total External Borrowing	145	2.86%
Other Long Term Liabilities:		
PFI	24	-
Finance Leases	4	-
Total Gross External Debt	173	-
Investments:		
<i>Managed in-house</i>		
Short-term investments:		
Instant Access	9	0.37%
Fixed Term Deposits	2	1.00%
<i>Managed externally</i>		
Fund Managers	4	1.56%
Property Funds	8	4.92%
Total Investments	23	2.21%
Net Debt	150	-

Non-treasury investments:	£000	Rate
Shares - Alderley Park Holdings Ltd	1,597	-
Shares - Manchester Science Parks Ltd	462	-
Loan - Alderley Park Holdings Ltd	1,531	-
Loan - Everybody Sport & Recreation	320	4.50%
Loan - Engenie Ltd	24	-
Investment Fund - Greater Manchester & Cheshire Life Sciences Fund	2,196	-
Total non-treasury investments	6,130	0.23%

Annex C

Prudential Indicators revisions to 2017/18 and 2018/19 - 2020/21

1. Background:

1.1 The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

2. Estimates of Capital Expenditure:

2.1 The Authority's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure	2017/2018	2018/2019	2019/20	2020/21	Future years
	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Total	111.0	127.1	121.8	77.2	0.0

Source: Cheshire East Finance

2.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2017/2018	2018/2019	2019/20	2020/21	Future years
	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Capital receipts	2.2	4.3	4.3	10.0	0.0
Government Grants	34.9	57.3	93.3	19.1	0.0
External Contributions	6.3	7.5	9.9	32.4	0.0
Revenue Contributions	0.5	2.7	0.0	0.0	0.0
Total Financing	43.9	71.8	107.5	61.5	0.0
Prudential Borrowing	67.1	55.3	14.3	15.7	-
Total Funding	67.1	55.3	14.3	15.7	0.0
Total Financing and Funding	111.0	127.1	121.8	77.2	0.0

Source: Cheshire East Finance

3. Estimates of Capital Financing Requirement:

3.1 The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

3.2 The CFR is forecast to rise over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Capital Financing Requirement	2017/2018 Estimate	2018/2019 Estimate	2019/2020 Estimate	2020/21 Estimate
	£m	£m	£m	£m
Total	347	390	393	403

Source: Cheshire East Finance

4. Gross Debt and the Capital Financing Requirement:

4.1 This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 Total debt is expected to remain below the CFR during the forecast period.

Debt	31/03/18 Revised	31/03/19 Revised	31/03/20 Revised	31/03/21 Revised
	£m	£m	£m	£m
Borrowing	183	240	270	318
Finance Leases	3	2	2	1
PFI Liabilities	24	23	22	22
Total Debt	210	265	294	341

Source: Cheshire East Finance

5. Authorised Limit and Operational Boundary for External Debt:

5.1 The Authority has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Authority and not just those arising from capital spending reflected in the CFR.

5.2 The **Authorised Limit** sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the Authority. It is measured on a daily basis against all external debt items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Authority's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

5.3 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

5.4 The Operational Boundary has been set on the estimate of the most likely, i.e. prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

5.5 The Operational Boundary links directly to the Authority's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

	2017/2018 Estimate £m	2018/2019 Estimate £m	2019/2020 Estimate £m	2020/21 Estimate £m
Authorised Limit for Borrowing	360	400	405	415
Authorised Limit for Other Long- Term Liabilities	27	25	24	23
Authorised Limit for External Debt	387	425	429	438
Operational Boundary for Borrowing	350	390	395	405
Operational Boundary for Other Long-Term Liabilities	27	25	24	23
Operational Boundary for External Debt	377	415	419	428

Source: Cheshire East Finance

6. Ratio of Financing Costs to Net Revenue Stream:

6.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/2018 Estimate %	2018/2019 Estimate %	2019/2020 Estimate %	2020/21 Estimate %
Total	3.24	3.91	4.70	5.36

Source: Cheshire East Finance

7. Incremental Impact of Capital Investment Decisions:

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2017/2018 Estimate £	2018/2019 Estimate £	2019/2020 Estimate £
Band D Council Tax	11.50	22.26	20.46

Source: Cheshire East Finance

8. Adoption of the CIPFA Treasury Management Code:

8.1 This indicator demonstrates that the Authority has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management

The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 23rd February 2012

The Authority has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

Annex D - MRP Statement 2018/19

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance.

For capital expenditure incurred before 1st April 2008 and for supported capital expenditure incurred on or after that date, MRP will be charged at 2% annuity rate over a 50 year period.

For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets, as the principal repayment on an annuity rate of 2%, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

(Option 3 in England and Wales)

For assets acquired by finance leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational.

Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20.