September 2017

Revised Treasury Management Strategy 2017/18

incorporating the Annual Investment Strategy and the Minimum Revenue Provision Policy

Torbay Council

Contents

1 Introduction

The Council defines its treasury management activities as:

> *"The management of the authority's investments and cash flows, it's 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."*

The revised Strategy for 2017/18 covers two main areas:

- Treasury management issues
    - the current treasury position;
    - treasury indicators which limit the treasury risk and activities of the Council;
    - prospects for interest rates;
    - the borrowing strategy;
    - the Annual Investment Strategy;
    - policy on use of external service providers;
    - reporting arrangements and management evaluation
    - other matters

- Capital issues
    - the capital plans and the prudential indicators;
    - the minimum revenue provision (MRP) policy.

2 Core funds and expected investment balances

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.

The table below includes the impact of the approved capital plan (as at quarter one 2017/18) which shows a borrowing requirement of £64million, but makes no assumption at this stage on the timing or level of the borrowing required. However, by the end of 2019/20 the Council may need to further borrow for any additional investment fund purchases which could add an additional £133m.

		2016/17 Actual	**2017/18 Revised**	**2018/19 Estimate**	**2019/20 Estimate**
Reserves		28	17	16	16
Capital Funding		9	5	5	5
Provisions		2	2	2	2
Other		0	0	0	0
Total "core" funds		**39**	**24**	**23**	**23**
Working capital*		5	10	10	10
Total (under)/over borrowing		(2)	(24)	(48)	(64)
Expected cash position		**42**	**10**	**(15)**	**(31)**

* Working capital balances shown are estimated year end; these may be higher mid year

Memorandum: - (Under)/Over borrowing		**2016/17 Actual**	**2017/18 Revised**	**2018/19 Estimate**	**2019/20 Estimate**
-Investment Fund		0	(7)	0	0
- Other		(2)	(17)	(48)	(64)
Total		**(2)**	**(24)**	**(48)**	**(64)**

3 Prospects for Interest Rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view (at August 2017).

	NOW	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
BANK RATE	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.75	0.75
3 month LIBID	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.60	0.70	0.80	0.90
6 month LIBID	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.70	0.80	0.90	1.00
12 month LIBID	0.60	0.60	0.70	0.70	0.80	0.80	0.90	1.00	1.10	1.20	1.30	1.40
5 yr PWLB	1.30	1.40	1.50	1.60	1.70	1.70	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	1.90	2.10	2.20	2.30	2.30	2.40	2.40	2.50	2.50	2.60	2.60	2.70
25 yr PWLB	2.60	2.80	2.90	2.90	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.30
50 yr PWLB	2.40	2.60	2.70	2.70	2.80	2.80	2.90	2.90	3.00	3.00	3.10	3.10

PWLB rates are quoted at the discounted Certainty Rate which Torbay Council is eligible for.

- Increases in investment returns are not expected in 2017/18 due to reduced GDP growth forecasts arising from uncertainty over Brexit. However, potential upside pressures from wage and inflation increases have gained traction in mid September 2017 and following comments from members of the MPC committee, some forecasters moved forward the timing of the first rise to February 2018 and possibly as early as November 2017.

- PWLB rates are forecast to rise, albeit slowly, as a world economic recovery is likely to see investors switching from save haven bonds to equities. Downside geopolitical risks remain (e.g. North Korea) but upside risks also exist from the USA if the Fed's pace and timing of rate increases and in the UK if inflation returns to significantly high levels.

- Economic forecasting is difficult in the current climate with many external factors weighing on the UK.

The borrowing rate forecasts give rise to affordable opportunities to fund the Council's significant capital plans in the short term.

However, cost of carry risks mean actual borrowing is best aligned to new capital ventures being realised and amounts taken limited to restrict levels of cash which is earning negligible returns over the next year and beyond.

An economic commentary provided by Capita Asset Services is provided at Appendix 3 for information.

4 Borrowing

4.1 The current borrowing position

The Council's treasury portfolio position at 31 March 2017, with forward projections (excluding new borrowing) is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing.

£m	2016/17 Actual	2017/18 Revised	2018/19 Estimate	2019/20 Estimate
Debt at 1 April	138	153	192	192
Change in Debt	15	39	0	0
Other long-term liabilities – School PFI	7	7	6	6
Other long-term liabilities – EFW PFI	12	12	12	12
Actual gross debt at 31 March	**172**	**211**	**210**	**210**
The Capital Financing Requirement	**174**	**235**	**258**	**274**
(Under) / over borrowing	**(2)**	**(24)**	**(48)**	**(64)**

The table above based on quarter one 2017/18 capital monitoring report shows Council capital financing requirement (excluding PFI liabilities) rising to £256m by the end of 2019/20 of which £64m is yet to be borrowed. If the estimate of £16m for 2020/21 is included along with a further £133m, if spent on investment properties (to the £200m limit), the level of Council debt will reach £405m. This total could increase if Council approve any additional schemes to be funded from borrowing such as for Town Centre Regeneration.

The Borrowing Strategy

The Council's Capital Investment Plan at quarter 1 is detailed within the Prudential Indicators at Appendix 1. This plan and the impact on core cash, indicate the need to borrow £103 million of funds over the next three years (£236m if investment fund reaches £200m) to ensure that gross debt is in line with the CFR. Of this sum £39m has already been borrowed in 2017/18. If the profile of capital spend changes, the in year treasury strategy will be updated and borrowing decisions expedited by the Chief Finance Officer under delegated powers.

It is proposed to use existing cash resources to initially fund planned capital expenditure in order to delay the additional borrowing cost to the General Fund until income streams are realised. Under this strategy new borrowing will be limited to levels sufficient to cover cash requirements for individual capital transactions and only at the point of reasonable certainty that the funds will be applied quickly.

The revised budget for payment of interest on debt for 2017/18, amended for new loans taken and assuming new borrowing provision detailed above, is based on an overall borrowing rate of 3.9% (4.34% in 2016/17).

The Chief Finance Officer has recognised the value in aligning current low borrowing rates to the business cases of specific schemes generating new income streams and this policy is currently being applied to Investment Fund related schemes. Decisions on other schemes will be made on a case by case basis and non-applicable schemes will continue to reflect the Council's average rate of borrowing.

In the event of a significant rise in the outlook for interest rates, the Chief Finance Officer will vary the strategy outlined above and take a greater proportion of the borrowing requirement earlier to protect the affordability of capital schemes over the longer term. 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, linked to forecast interest rates, 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. No borrowing in advance will be made in relation to any capital project funded from borrowing until individual schemes have been approved by Council and there is a high assumption of spend occurring.

Finance officers continue to monitor alternative funding sources to PWLB. Discussions have been held with banking partners on market structures available and while these currently offer no advantage to PWLB, groundwork has been prepared if the Council's circumstances change in the future.

Treasury Indicators for limits to borrowing activity are published within Appendix 1 to this report.

5 Annual Investment Strategy

5.1 Investment policy

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.**

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 in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings. The creditworthiness policy adopted is detailed at Appendix 4.

A decision by the Chief Finance Officer to temporarily remove all Eurozone Banks, regardless of rating, from the approved counterparty list for in-house investments remains in place but does not form part of this policy.

Investment instruments identified for use in the financial year are listed at Appendix 5 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be set within the schedules accompanying the Council's Treasury Management Practices.

5.2 Investment strategy

Investment rates are forecast to remain at low levels during 2017/18.

Expected cash levels are likely to decrease significantly over the period as internal resources are used to initially fund income generating capital schemes and delay the cost of borrowing, rather than maintain cash levels earning negligible investment returns.

Based on strategic cash flow forecasts £15million of the Council's investments can be regarded as core cash and be invested over a longer periods in higher risk/return instruments. Previous investment decisions have locked out £12 million of these funds beyond 2017/18 to gain higher returns (average 1.07%) and £3 million has been placed with the Local Authorities Property Fund (current yield around 4.50%)

A decision was taken in December 2016 to pay £10million of short term cash to TOR2 in advance of 12 months contracted fees, to earn a significant discount. This facility will be renewed subject to negotiation.

Under the strategy of using internal resources as internal borrowing for capital expenditure, remaining cash will need to be maintained in short term liquidity instruments. As such extensive use will be made of the Council's money market funds and fixed deposits are expected to be limited to short 3 or 6 month durations and instant access instruments to maintain sufficient liquidity. The expected return on these investments is unlikely to exceed 0.3%

An analysis of the current performance of the Council's exposure to peer to peer lending (Funding Circle) is produced in the following table.

Funding Circle (peer to peer lending) to end August 2017		
Total Investment	**£220,000**	
No. of loan parts	2646	
Defaulted loans*	£4,696	
Defaults as a proportion of principal invested	2.10%	
Expected bad debt rate of portfolio	1.73%	
	2017/18	Whole Life
Interest earned	£7,987	£27,625
Gross yield	8.18%	8.41%
Return net of fees and bad debts	**6.64%**	**5.85%**
Risk Analysis		
Proportion of secured/unsecured loans		
- Secured	67%	
- Unsecured	33%	
Proportion of loans by credit rating		
- A+	75%	
- A	19%	
- B	5%	
- Downgraded	1%	

* This is the current level of defaults and is subject to being reduced by guarantees and recoveries pursued by Funding Circle.

The Treasury Management Outturn report for 2016/17 reported a decision by the Chief Finance Officer to restrict Funding Circle operations to only those loans secured by a first charge on assets, together with news of Funding Circle changing their business plan to focus on loans to small businesses loans and withdrawing new property development loans. The combination of these two events effectively result in Funding Circle investment being unwound. Members requested the Chief Finance Officer review his restriction during 2017/18.

A further development has recently been announced by Funding Circle whereby the facility to pick and choose individual loans is being removed and all selections will be automated based on a chosen credit criteria; there will be no provision to stipulate secured only loans. Taking this new development into account the Chief Finance Officer maintains the earlier restriction remains proportionate and the new change by Funding Circle are too far removed from an appropriate investment instrument for Council funds.

No further funds will therefore be invested in Funding Circle and the current holding will be wound down as individual loans are repaid.

Peer to peer lending will remain on the approved list of investments and Officers will continue to review other providers that can satisfy the two major criteria; (a) a credit rating policy and (b) a first charge on borrower assets in the event of default.

The overall investment performance will be benchmarked against the 7-Day LIBID market rate and is budgeted at a revised level of 0.65%

A new directive (MiFID II) from the European Union affecting financial dealing will be implemented into UK law in January 2018. Torbay Council is currently classed as a “professional” client with its investment counterparties, recognising officers have knowledge and expertise in dealing with more complex investment instruments. Under the new directive all Local Authorities will by default classed as “retail” clients meaning that banks and other counterparties will only be able to offer the most basic of investment vehicles e.g. fixed deposits, notice accounts. Authorities can apply to be reclassified as a professional client and this would be required for each investment with each counterparty. There is a possibility that the Council will not pass the criteria for reclassification denying access to higher risk/return markets in future years.

Investment treasury indicator and limits are published within Appendix 1 to this report

6 Treasury Management Consultants

Capita Asset Services was reappointed as the Council's external treasury management advisors for three years from February 2016, following a full tender process.

The Council acknowledges that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Chief Finance Officer 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 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.

7 Reporting Arrangements and Management Evaluation

Members will receive the following reports for 2017/18 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy
- Mid-Year Treasury Review report
- Annual Treasury Outturn report

The CFO will inform the Mayor/Executive Lead for Finance of any long-term borrowing/repayment undertaken or any significant events that may affect the Council's treasury management activities. The CFO will maintain a list of staff authorised to undertake treasury management transactions on behalf of the Council.

The Chief Finance Officer is authorised to approve any movement between borrowing and other long-term liabilities within the Authorised Limit (see Appendix 1). Any such change will be reported to the next meeting of the Council.

The impact of these policies will be reflected as part of the Council's revenue budget and therefore will be reported through the quarterly budget monitoring process.

The Council's management and evaluation arrangements for Treasury Management will be as follows:

- Monthly monitoring report to the Chief Finance Officer, Finance Manager-Budget & Technical, Executive Lead for Finance and Group Leaders
- Quarterly meeting of the Treasury Manager/ Finance Manager-Budget & Technical/ Chief Finance Officer to review previous quarter performance and plan following period activities
- Regular meetings with the Council's treasury advisors
- Membership and participation in the Capita Benchmarking Club
- The Audit Committee is the body responsible for scrutiny of Treasury Management.

8 Other Matters

8.1 Loans to organisations

The Council has provided loans or loan facilities to the following organisations. These are policy decisions and not part of the treasury management strategy except for identifying any impact on cash balances:

Organisation	Current Value of loan	Full Term of Loan	Rate
Torbay Economic Development Company*	£575,000	25 years	Linked to Council borrowing Rate
Torbay Economic Development Company	£1,480,298	25 years	Linked to Council borrowing Rate
Academy Schools	£130,000	3 to 7 years	Linked to Council borrowing Rate
Babbacombe Cliff Railway	£10,000	10 years	Linked to Council Borrowing Rate
Housing Loans	£1,000	No new loans issued. Term linked to individual mortgages	Linked to market mortgage rates
Sports Clubs	£33,000	10 - 20 years	Linked to Council Borrowing Rate
Torbay Coast & Country side Trust	£895,000	45 years	Linked to Bank Base Rate
Parkwood Leisure *	£1,700,000	12 years	Linked to Council borrowing Rate
South Devon College	£4,000,000	25 years	Linked to Council borrowing Rate

*Not fully drawn down as at 14th September 2017

The current overall rate of interest on these loans is around 4%.

8.2 Advancing cash

If approved the Council will advance cash to Torbay Council schools at a rate equivalent to that of the forecast investment yield (to reflect the lost investment opportunity), with the option of an additional 0.25% risk premium. The service will have to identify the funding for this advance from revenue or reserves in the year of the advance.

8.3 Investing cash for Local Payment Scheme (LPS) Schools

If agreed by the Chief Finance Officer the Council will invest LPS school surplus balances on a temporary basis and endeavour to match Bank Rate on these investments on a variable basis. This will be for cash on a longer-term basis and will not apply to daily cash flow balances.

8.4 Soft Loans

Accounting for financial instruments require the recognition of soft loans i.e. where a loan is made at a lower than ‘competitive’ rate the cost implicit in achieving the lower rate must be reflected in the Council’s accounts.

13.5 Anti-Money Laundering

The Council will comply with all relevant regulations.

Appendix 1

Prudential & Treasury Management Indicators 2017/18 – 2020/21

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

Capital Expenditure

The Council's Capital Plan monitoring report for quarter 2 will be presented to Council in October 2017 and summarised below for approval are the required prudential indicators for capital expenditure:

Capital expenditure £m	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total at Q1 2017/18	**84**	**46**	**27**	**12**

It should be noted that the timing of capital expenditure financed from borrowing is currently very uncertain which makes planning difficult. If a further £133m is spent on investment properties (to the £200m limit) then the totals shown above will increase by £133m to £302m. There is significant uncertainly over the timing of new expenditure on the £133m balance on the Investment Fund and a number of regeneration related projects that have not yet started such as Claylands (£7m), the Electronics and Photonics Innovation Centre (EPIC) (£2m) and Upton Place (£14m).

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure £m	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital receipts	1	1	1	0
Capital grants	16	16	6	2
Capital reserves	0	2	0	0
Capital Contributions	1	0	0	0
Revenue	1	0	0	0
Borrowing need for the year	**65**	**27**	**20**	**10**

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

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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include the financing of the asset and so the Council is not required to separately borrow for these schemes. The Council currently has £20m of such schemes, mostly PFI schemes, within the CFR.

The Council is asked to approve the CFR projections below:

£m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement				
Total CFR *	**174**	**235**	**258**	**274**
Movement in CFR	**61**	**23**	**16**	**6**

Movement in CFR represented by				
Net financing need for the year (above)	65	27	20	10
Less MRP, VRP and other financing movements **	(4)	(4)	(4)	(4)
Movement in CFR	**61**	**23**	**16**	**6**

Note * - If an additional £133m on investment properties is spent the CFR will rise to £413m.

Note ** - MRP to be re calculated – estimate still at budget 17/18 level.

Affordability prudential indicators

The overall capital and control of borrowing prudential indicators are set out above, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income but excluding investment property income) to support the projected CFR as identified above against the 2017/18 net revenue budget.

%	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Ratio	9	11	12	13

Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the capital plan budget 2017/18 compared to the Council's existing approved commitments and current plans.

Incremental impact of capital investment decisions on the Band D Council Tax

%	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council Tax - Band D	0	0	0

As there were no schemes funded from borrowing proposed as part of 2017/18 budget process this indicator is still nil. However, the Council has subsequently approved further schemes funded from borrowing which do have an ongoing revenue cost. On the assumption that the interest and MRP costs are 5% per annum of the capital expenditure then £12m of spend will cost £600k per annum which equals 1% extra on council tax, which is £13.77 for a band D property. Therefore if in 2017/18 and future years another £236m of borrowing is incurred this would increase Council tax by 20%. However this calculation does not include any income stream associated with the new assets.

Limits on Borrowing and Long-Term Liabilities

The Operational Boundary

This is the limit beyond which external borrowing and long-term liabilities are not normally expected to exceed. In most cases, this would be linked to the CFR, but may be lower or higher depending on the levels of actual borrowing.

Operational boundary £m	2016/17 Final	2017/18 Revised	2018/19 Estimate	2019/20 Estimate
Borrowing	148	290	430	430
Long term liabilities	40	20	20	20
Total	188	310	450	450

The Authorised Limit for external borrowing and long-term liabilities.

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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.

Authorised limit £m	2016/17 Final	2017/18 Revised	2018/19 Estimate	2019/20 Estimate
Borrowing	167	310	450	450
Other long term liabilities	40	20	20	20
Total	207	330	470	470

Limits on Activity

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 variable interest rate exposure.

This identifies a maximum limit for variable interest rates based upon the debt position net of investments

Upper limits on fixed interest rate exposure.

This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

Maturity structure of borrowing

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

Interest rate Exposures				
	2016/17 Upper %	**2017/18 Upper %**	**2018/19 Upper %**	**2019/20 Upper %**
Limits on fixed interest rates: • Debt • Investments	100 80	100 80	100 80	100 80
Limits on variable interest rates: • Debt • Investments	30 85	30 85	30 85	30 85

Maturity Structure of fixed interest rate borrowing 2017/18			
	Lower	**Upper**	**Projected 31/03/2018**
Up to 10 years	5%	50%	20%
10 to 20 years	5%	50%	20%
20 to 30 years	5%	60%	15%
30 to 40 years	10%	50%	20%
Over 40 years	0%	50%	25%

Investment Treasury Indicator and Limit

Total principal funds invested for greater than 364 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.

Maximum principal sums invested for over 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 364 days	35	25	25

Appendix 2

Policy on Minimum Revenue Provision for 2017/18

The Minimum Revenue Provision is a statutory charge that the Council is required to make from its revenue budget. This provision enables the Council to generate cash resources for the repayment of borrowing.

The basis for the calculation of the provision is prescribed by legislation (Local Authorities (Capital Finance and Accounting (England) (Amendment) Regulations 2012, which states that Councils are required to "determine for the current financial year an amount of MRP that it considers to be prudent" and prepare an annual statement on their MRP calculation to their full Council.

One of the aims of this legislation is to ensure that the repayment of principal owed for capital expenditure is charged on a prudent basis. Central Government guidance says:

> "*the broad aim of prudent provision 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."*

For Supported Borrowing, (borrowing funded by central government), the Council will charge MRP at 2% of the balance as at 31 March after the deduction of the value of adjustment A (a set value in 2004), fixed at the same cash value of that the whole debt is repaid after 50 years.

The Council will charge a VRP for the supported borrowing within the adjustment A value that is outstanding as at 31 March relating to transferred debt from Devon County Council fixed at the same cash value of that the whole debt is repaid after 50 years (which is similar to the supported borrowing calculation).

For capital expenditure funded from unsupported borrowing, less any repayment to date, the Council will make a provision based on the cumulative expenditure incurred on each asset in the previous financial years using a prudent asset life, which reflects the estimated usable life of that asset. (See table below).

The MRP for each asset will be calculated using the asset life method using an annuity calculation. An adjustment to the MRP calculation will be made where there is expenditure in the previous financial year, but the asset is not yet operational. MRP will be calculated on the total expenditure on that asset in the year after the asset becomes operational.

The Council will continue to charge services for their use of unsupported borrowing using a prudent asset life (or a shorter period) on an annuity calculation (or a straight line basis if asset if no MRP). Where possible the same asset life and borrowing interest rate will be used for both the charge to services and the calculation of the MRP.

To mitigate any negative impact from the changes in accounting for leases and PFI schemes the Council will include in the annual MRP charge an amount equal to the amount that has been taken to the balance sheet to reduce the balance sheet liability for a PFI scheme or a finance lease. The calculation will be based on the annuity method using the Internal Rate of Return (IRR) implicit in the PFI or lease agreement.

Where loans are given for capital purposes they come within the scope of the prudential controls established by the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2008.

If a loan agreement does not include contractual commitments that the funds be put towards capital expenditure no MRP will be made, if however capital contract commitments are included then an MRP will be made on a prudent basis using Asset Life Method linked to the life of the asset being funded.

The Capital Financing Requirement (CFR) will increase by the amount of the loan. Once the funds are returned to the local authority, the returned funds are classed as a capital receipt with those receipts being earmarked specifically to that loan, and the CFR and loan will reduce accordingly. If the expectation is that funds will be repaid in full at some point in the future, there is no requirement to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position of each loan will be reviewed on an annual basis by Chief Finance Officer.

Where expenditure is on an Investment Property a MRP may not be applied where there is a clear decision or realistic expectation that an asset purchased as an investment property will be sold in the future where the capital receipts from that sale will be set aside to enable repayment of the borrowing associated with the asset. These assets will be reviewed each year to asses any reduction in value including acquisition costs. If any reduction in value has occurred then an MRP will be charged to recover the loss in the medium term, such as over five to ten years.

Where relevant, the suggested asset lives for certain types of capitalised expenditure as detailed in the MRP guidance issued by DCLG will be used.

Each asset life will be considered in relation the asset being constructed by the Chief Finance Officer; however as a guide the following are typical asset lives that will be used.

Asset Type	Asset Life
Freehold Land (speciifed in DCLG statutory gudiance)	50 years
Buildings	40 years
Investment Properties	40 years
Software	10 years
Vehicles & Equipment	7 years
Highway Network	40 years
Structural Enhancements	25 years
Infrastructure	40 years

For capital expenditure where land and buildings are not separately identified a blended asset life can be used (e.g. an assumption that 30% of the value is land results in an asset life of 43 years).

Appendix 3

Economic Commentary (Capita Treasury Services – July 2017)

The UK GDP annual growth rates in each calendar year 2013 – 2016 of 1.9%, 3.1%, 2.2% and 1.8%, have all been the top rate, or near top rate, of any of the G7 countries in every year. It is particularly notable that the UK performance was repeated in 2016, a year in which the Bank of England had forecast in August 2016 that growth would be near to zero in the second half of the year due to the economic shock it expected from the result of the Brexit referendum in June. However, it has had to change its mind and in its February and May 2017 Inflation Reports, the Bank upgraded its forecasts for growth (May Report - 2017 1.9%, 2018 and 2019 1.9%). However over these years, it also expects inflation to accelerate towards nearly 3% as increases in costs as a result of the fall in the value of sterling since the referendum, gradually feeds through into the economy, though it should fall back to 2.2% in 2019. Provided those cost pressures do not feed through into significantly higher domestically generated inflation within the UK, the MPC is expected to 'look though' this one off blip upwards in inflation. Wage inflation, which is a key driver of domestically generated price pressures, is currently subdued. There is, though, a potential risk that the MPC might muster a majority to reverse the emergency 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time.

GDP growth in the US has been highly volatile in 2016 but overall mediocre, at an average of 1.6% for the year. Quarter 1 in 2017 has also been mediocre at 1.4% but current indications are that growth could rebound strongly in quarter 2. The disappointment so far has been the lack of decisive action from President Trump to make progress with his promised fiscal stimulus package. The Fed has, therefore, started on the upswing in rates now that the economy is at or around "full employment" and inflationary pressures have been building to exceed its 2% target. It has, therefore, raised rates four times, with the last three following quickly on one another in December 2016 and March and June 2017. One or two more increases are expected in 2017 and possibly four in 2018.

Growth in the EU improved in 2016, to 1.7%, after the ECB cut rates into negative territory and embarked on massive quantitative easing during the year. The ECB is now forecasting growth of 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. It has committed to continuing major monthly quantitative easing purchases of debt instruments, though in April 2017 it reduced the rate from €80bn per month to €60bn, to continue until the end of 2017, in order to stimulate growth and to get inflation up to its 2% target.
There are major concerns about various stresses within the EU; these could even have the potential to call into question the EU project. The Dutch and French elections passed off without creating any waves for the EU but we still have a national election in Germany on 22 October; this is not currently expected to cause any significant change. What could be more problematic is the general election in Austria on 15 October where a major front runner is the Freedom Party which is strongly anti-immigration and anti EU. There is also a risk of a snap general election in Italy before the final end possible date of 20 May 2018. A continuing major stress point is dealing with the unsustainable level of national debt in Greece in the face of implacable opposition from Germany to any further bail out. High levels of unemployment in some EU countries and the free movement of people within the EU, together with the EU's fraught relationship with Turkey in controlling such people movements, are also major stress issues. On top of which the EU also now has to deal with Brexit negotiations with the UK.

China is expected to continue with reasonably strong growth, (by Chinese standards), of 6.5% in 2017. However, medium term risks are increasing. Japan has only achieved 1% growth in 2016 and is struggling to get inflation to move from around 0%, despite massive fiscal stimulus and monetary policy action by the Bank of Japan.

Appendix 4
Creditworthiness Policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands, illustrated below, which indicate the relative creditworthiness of counterparties. The Chief Finance Officer applies and reviews suitable financial and durational bands to each of these bands.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	**1.25**	**1.5**	**2**	**3**	**4**	**5**	**6**	**7**
up to 5yrs	up to 5yrs	up to 5yrs	up to 2yrs	up to 2yrs	up to 1yr	up to 6mths	up to 100days	no colour

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored on a monthly basis and for each investment transaction. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition the CFO will also use market data and market information, information on any external support for banks to help support its decision making process.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ and also have banks operating in sterling markets. The exception to this is the United Kingdom which has been exempted from the rating criteria to ensure cash services can continue to operate following a downgrade to AA.

The list of countries that qualify using this credit criteria as at the date of this report (based on the lowest available rating) are shown below and this list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

AAA		AA+
Australia	Netherlands	
Canada	Norway	Finland
Denmark	Singapore	Hong Kong
Germany	Sweden	U.S.A.
Luxembourg	Switzerland	
Exempted from Sovereign Rating Criteria		
United Kingdom		

Appendix 5

Approved Investment Instruments: Specified and Non-Specified

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Specified Investments

All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ rating criteria where applicable.

Investment Type	* Minimum ‘High’ Credit Criteria
Debt Management Agency Deposit Facility	--
Term deposits – local authorities	LAs and other public bodies classified as colour band “Yellow”
Term deposits – banks and building societies	Creditworthiness system colour band “Green” and above
UK part nationalised banks	Creditworthiness system colour band blue
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating AA+
1. Government Liquidity Funds	* MMF rating AAA
2. Money Market Funds	* MMF rating AAA
3. Enhanced Money Market Funds with a credit score of 1.25	* MMF/bond fund rating AAA
4. Enhanced Money Market Funds with a credit score of 1.5	* MMF/bond fund rating AAA
5. Bond Funds	* bond fund rating AAA
6. Gilt Funds	* bond fund rating AAA

Non-Specified Investments

These are any investments which do not meet the Specified Investment criteria. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The maturity limits recomended will not be exceeded. Under the delegated powers the Chief Finance Officer can set limits that are lower based on the latest economic conditions and credit ratings.

Investment Type	**Minimum Credit Criteria**	**Max investment or % of total investments**	**Max. maturity period ***
UK nationalised/part-nationalised banks (maturities over one year)	Creditworthiness system colour band "Blue"	50%	2 years
Term deposits (over one year) – local authorities and other public sector bodies	LAs and other public bodies classified as colour band "Yellow"	50%	5 years
Term deposits (over one year) – banks and building societies	Creditworthiness system colour band "Purple"	75%	2 years
Certificates of deposits issued by banks and building societies (maturities under one year)	Creditworthiness system colour band "Green" and above	50%	1 year
Certificates of deposits issued by banks and building societies (maturities over one year)	Creditworthiness system colour band "Purple"	50%	1 year
UK Government Gilts/Treasury Bills	Sovereign rating AA+	100%	5 years
Bonds issued by multilateral development banks	AA+	50%	5 years
Sovereign bond issues (other than the UK govt)	Sovereign rating AA+	50%	5 years
Structured Deposits	Creditworthiness system colour band "Orange" <1 year "Purple" >1 year	25%	2 years
Commercial paper issuance by UK banks covered by UK Government guarantee	Sovereign rating AA+	35%	5 years
Commercial paper other	Creditworthiness system colour band "Red" and above	35%	5 years
Floating Rate Notes	Long-term AA	35%	5 years
Property Fund: *the use of these investments would normally constitute capital expenditure*	--	£10million	5 years
Property Fund: *not classified as capital expenditure*	--	£10million	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):**-** 1.Bond Funds 2.Gilt Funds	AAA	35%	5 years
Corporate Bonds	AA	35%	5 years
Other debt issuance by UK Banks covered by UK Government guarantee	Sovereign rating AA+	35%	5 years
Peer to Peer Lending	Funding Circle rating B or equivalent	£500,000 Individual loan - £2,000	5 years