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February 2017

DRAFT Treasury Management Strategy 2017/18

incorporating the Annual Investment Strategy and the Minimum Revenue Provision Policy

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 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 two 2016/17) but makes no assumption at this stage on the timing or level of borrowing required. However the forecast shows that by the end of 2019/20 the Council will need to borrow in excess of £56 million, (assuming £10m of core funds are used to support capital expenditure).

	2015/16 Actual	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Reserves	29.7	20.2	15.7	14.6	15.0
Capital Funding	4.0	5.0	5.0	5.0	5.0
Provisions	3.0	2.0	2.0	2.0	2.0
Other	2.3	0.0	0.0	0.0	0.0
Total “core” funds	**40.0**	**27.2**	**22.7**	**21.6**	**22.0**
Working capital*	7.4	0	0	0	0
(Under)/over borrowing	7.2	(3.9)	(31.7)	(48.3)	(66.3)
Expected investments	**54.6**	**23.3**	**(9.0)**	**(26.7)**	**(44.3)**

* Working capital balances shown are estimated year end; these may be higher midyear and assume advance to TOR2 is reoccurring.

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.

	Dec-16	Mar-17	Jun-17	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%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the Bank of England Monetary Policy Committee (MPC) meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a ‘hard Brexit’, the fall in the value of sterling, and an increase in inflation expectations. There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

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 2016, with forward projections (excluding new borrowing requirements) 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	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External Debt					
Debt at 1 April	138.1	138.1	138.1	134.1	132.1
Expected change in Debt	-	-	(4.0)	(2.0)	0.0
Other long-term liabilities – School PFI	7.9	7.4	6.8	6.2	5.6
Other long-term liabilities – EFW PFI	12.3	12.2	12.1	11.9	11.7
Actual gross debt at 31 March	**158.3**	**157.7**	**153.0**	**150.2**	**149.4**
The Capital Financing Requirement	**151.1**	**161.6**	**184.7**	**198.5**	**215.7**
(Under) / over borrowing	**7.2**	**(3.9)**	**(31.7)**	**(48.3)**	**(66.3)**

4.2 The Borrowing Strategy

The Council's Capital Investment Plan at quarter 2 is detailed within the Prudential Indicators at Appendix 1. This plan and the impact on core cash, outlined in section 2 indicate the need to borrow £66 million of new funds over next four years to ensure that gross debt is in line with CFR. 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.

The strategy for 2016/17 anticipated new borrowing of up to £15million to finance capital expenditure in year. Interest rates for borrowing levels have since, post "Brexit" referendum, risen sharply and are forecast to increase slowly later in 2017.

It is proposed to use existing cash resources to initially fund planned capital expenditure in order to delay the additional cost to the General Fund until income streams are realised. Under this strategy new borrowing is not anticipated, based on the 2016/17 quarter two position, until 2017/18 when up to £20 million could be needed to maintain sufficient cash resource.

Consideration will be given to taking up to 50% of the medium term borrowing on an Equal Instalment of Principal (EIP) basis as a "hedge" against a proposed policy of no MRP on Investment Fund acquisitions where the future sale of that asset is planned. Capital repayments of these loans would be met from existing MRP provisions.

The budget for payment of interest on debt for 2017/18, assuming new borrowing provision detailed above, is based on an overall borrowing rate of 4.30% (4.34% in 2016/17).

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 proportion of the borrowing requirement earlier. The Council will not borrow more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. 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.

Council approved in September 2016 to investigate the option of a council owned housing company with a potential capital investment or loan by the Council up to £60 million based on the outline business case. The impact of a proposed Housing Company on the borrowing requirement will be evaluated separately as and when any future approval for such a company is set by Council and financing details are clearer.

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 core cash levels are likely to decrease significantly over the period as internal resources are used to initially fund income generating capital schemes.

Previous investment decisions have locked out £12 million of funds beyond 2017/18 to gain higher returns (average 1.07%). A further decision was made to pay £10million to TOR2 in advance of 12 months contracted fees, to earn a significant discount.

Remaining cash will be required in year and as such investments 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%

The Agreement with the external fund manager is due to be terminated by mutual agreement before the end of 2016/17. The Council will retain direct access to the enhanced money market fund provided by Aberdeen Asset Management which is forecast to return 0.70% - 0.90% during 2017/18.

Consideration will continue to be given to diversifying an element of the fund holding into a Property Fund if forecast rates are advantageous, in particular compared to costs of borrowing and, importantly, if the timing of the expenditure in the capital plan funded from borrowing permits. The current and proposed Investment Strategy has an approved limit in property funds of £10 million. Officers will continue to monitor performance and associated risks and any such investment will be made by the Chief Finance Officer under existing authority.

Officers will continue to expand the Council's exposure to peer to peer lending up to the approved limit. An analysis of the current performance of the Funding Circle holding is produced in the following table.

Funding Circle (peer to peer lending) to December 2016		
Total Investment	**£225,000**	
No. of loan parts	1103	
Bad debts written off	£2,445.46	
Bad debts as a proportion of principal invested	1.09%	
Expected bad debt rate of portfolio	1.73%	
	2016/17	Whole Life
Interest earned	£12,125.63	£14,491.43
Average principal	£143,800	£176,400
Gross yield	8.46%	8.38%
Return net of fees and bad debts	**6.30%**	**6.28%**
Risk Analysis		
Proportion of secured/unsecured loans		
- Secured	55%	
- Unsecured	45%	
Proportion of loans by credit rating		
- A+	71%	
- A	21%	
- B	6%	
- Downgraded	2%	

The overall investment performance will be benchmarked against the 7-Day LIBID market rate and is budgeted at 0.79%

The limits per counterparty are for the principal value only, therefore at a point in time any interest due would be in addition the limit; however as with fund manager and peer to peer lending, interest is repaid on a regular basis.

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
Suttons Seeds Ltd **	£1,500,000**	3 years	Market rate
Torbay Coast & Country side Trust	£895,000	45 years	Linked to Bank Base Rate

*Not fully drawn down as at 31st December 2016

**Original advance repaid and no further drawdowns on the facility to date (expires 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 – 2019/20

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 was presented to Council on 8 December 2016 and summarised below for approval are the required prudential indicators for capital expenditure:

Capital expenditure £m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	**23**	**32**	**48**	**24**	**23**

It should be noted that the timing of capital expenditure financed from borrowing is currently very uncertain which makes planning difficult. There is significant uncertainly over the timing of the expenditure on the £50m Investment Fund and a number of regeneration related projects that have not yet started such as Claylands (£7m), Electronics and Photonics Innovation Centre (EPIS) (£2m) and White Rock (£7m)

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	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Capital receipts	2.6	0.8	1.0	0.8	0.0
Capital grants	10.6	15.8	18.8	5.7	2.3
Capital reserves	0.6	0.3	1.2	(0.1)	(0.2)
Capital Contributions	0.2	0.2	0.5	0.0	0.0
Revenue	0.9	0.4	0.1	0.1	0.0
Net financing need for the year	**7.7**	**14.2**	**26.9**	**17.7**	**21.1**

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	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Capital Financing Requirement				
Total CFR	**151.1**	**161.6**	**184.7**	**198.5**
Movement in CFR	**10.5**	**23.1**	**13.8**	**17.2**
Movement in CFR represented by				
Net financing need for the year (above)	14.2	26.9	17.7	21.1
Less MRP, VRP and other financing movements	(3.7)	(3.8)	(3.9)	(3.9)
Movement in CFR	**10.5**	**23.1**	**13.8**	**17.2**

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) against the net revenue budget (which is expected to reduce over the next few years).

%	2016/17 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Ratio	8	9	9	9

The estimates of financing costs include current level of borrowing and maturities but no assumption in relation to any new borrowing required.

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. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

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

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 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Borrowing	148	161	208	224
Long term liabilities	40	20	20	20
Total	188	181	228	248

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 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Borrowing	167	235	285	305
Other long term liabilities	40	20	20	20
Total	207	255	305	325

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.

Interest rate Exposures				
	2016/17 Upper %	2017/18 Upper %	2018/19 Upper %	2019/20 Upper %
Limits on fixed interest rates:				
• Debt	100	100	100	100
• Investments	80	80	80	80
Limits on variable interest rates:				
• Debt	30	30	30	30
• Investments	75	75	75	75

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

Maturity Structure of fixed interest rate borrowing 2017/18			
	Lower	**Upper**	**Projected 31/03/2017**
Up to 10 years	5%	50%	13%
10 to 20 years	5%	50%	21%
20 to 30 years	10%	60%	26%
30 to 40 years	10%	50%	25%
Over 40 years	0%	50%	15%

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	30	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 2016 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 2016 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. 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 – December 2016)

The Monetary Policy Committee (MPC) cut the Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects (i.e. by raising Bank Rate, which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

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

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
    - Italian constitutional referendum 4.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
    - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
    - Dutch general election 15.3.17;
    - French presidential election April/May 2017;
    - French National Assembly election June 2017;
    - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

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	5 years