



FLINTSHIRE COUNTY COUNCIL

**DRAFT
TREASURY MANAGEMENT
STRATEGY**

2017/18

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Treasury Management Strategy Report 2017/18

The Council is recommended to:

- **approve the Treasury Management Strategy for 2017/18**
- **approve the Treasury Management Indicators for 2017/18**

1.0 Introduction

In April 2012 the Council 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 Council to approve a treasury management strategy before the start of each financial year.

In addition, the Welsh Government (WG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance.

The successful identification, monitoring and control of risk are central to the Council's treasury management strategy as the Council 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.

In accordance with WG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly.

2.0 Economic Context (including Interest Rate Forecast – as provided by Arlingclose Ltd, November 2016).

Economic background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, the US economy and its labour market showing steady improvement, with Federal Reserve increasing interest rates in December 2016 by 0.25%. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

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. 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 continue to fall.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a distinct possibility, to keep long-term interest rates low.

Table 1: Interest rate forecast

| | Bank Rate | 3 month LIBID | 12 month LIBID | 20 year Gilt rate | 50 year Gilt rate |
|---------|-----------|---------------|----------------|-------------------|-------------------|
| Q1 2017 | 0.25 | 0.25 | 0.60 | 1.70 | 1.60 |
| Q2 2017 | 0.25 | 0.25 | 0.50 | 1.50 | 1.40 |
| Q3 2017 | 0.25 | 0.25 | 0.50 | 1.40 | 1.30 |
| Q4 2017 | 0.25 | 0.30 | 0.50 | 1.40 | 1.30 |
| Q1 2018 | 0.25 | 0.30 | 0.50 | 1.40 | 1.30 |
| Q2 2018 | 0.25 | 0.30 | 0.50 | 1.40 | 1.30 |
| Q3 2018 | 0.25 | 0.30 | 0.50 | 1.40 | 1.30 |
| Q4 2018 | 0.25 | 0.30 | 0.60 | 1.45 | 1.35 |
| Q1 2019 | 0.25 | 0.30 | 0.70 | 1.50 | 1.40 |
| Q2 2019 | 0.25 | 0.30 | 0.85 | 1.55 | 1.45 |
| Q3 2019 | 0.25 | 0.30 | 0.90 | 1.60 | 1.50 |
| Q4 2019 | 0.25 | 0.30 | 0.90 | 1.65 | 1.55 |

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.3%, and that new long-term loans will be borrowed at a weighted average rate of 2.2%.

3.0 Current Treasury Portfolio

The Council's treasury portfolio as at 31st December 2016 was as follows:

Table 2: Current Treasury Portfolio

| | Principal £m | Interest rate % |
|---------------------------------|---------------|-----------------|
| Investments: | | |
| Call accounts | - | - |
| Money market funds | 7.1 | 0.27 |
| Short-term deposits | 8.0 | 0.38 |
| Long-term deposits | - | - |
| Total Investments | 15.1 | 0.33 |
| Borrowing: | | |
| Short-term loans | - | - |
| Long-term PWLB loans (fixed) | 222.36 | 5.26 |
| Long-term PWLB loans (variable) | 10.00 | 0.46 |
| Long-term market loans (LOBOs) | 18.95 | 4.53 |
| Total Borrowing | 251.31 | 5.01 |
| Net Borrowing | 236.21 | |

4.0 Local Context

Forecast changes in the sums in section 3 are shown in the balance sheet analysis in the table below.

Table 3: Balance Sheet Summary and Forecast

| | 31.3.16 Actual £m | 31.3.17 Estimate £m | 31.3.18 Estimate £m | 31.3.19 Estimate £m | 31.3.20 Estimate £m |
|-----------------------------------------------------------------------------|----------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Council Fund Capital Financing Requirement (Borrowing only) | 169 | 183 | 186 | 192 | 193 |
| Housing Revenue Account Capital Financing Requirement (Borrowing only) | 105 | 115 | 126 | 133 | 138 |
| Capital Financing Requirement (Borrowing only) | 274 | 298 | 312 | 325 | 331 |
| Less: Current borrowing | -251 | -251 | -250 | -250 | -250 |
| Funding Required | 23 | 47 | 62 | 75 | 81 |
| Less: Usable reserves | -51 | -34 | -28 | -26 | -25 |
| Less: Working capital | -5 | 2 | 4 | 4 | 7 |
| Investments / New borrowing (called the Liability Benchmark) | 33 | -15 | -38 | -53 | -63 |

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 below the CFR, sometimes known as internal borrowing. Internal borrowing is currently cheaper and incurs lower credit risk than external long term borrowing.

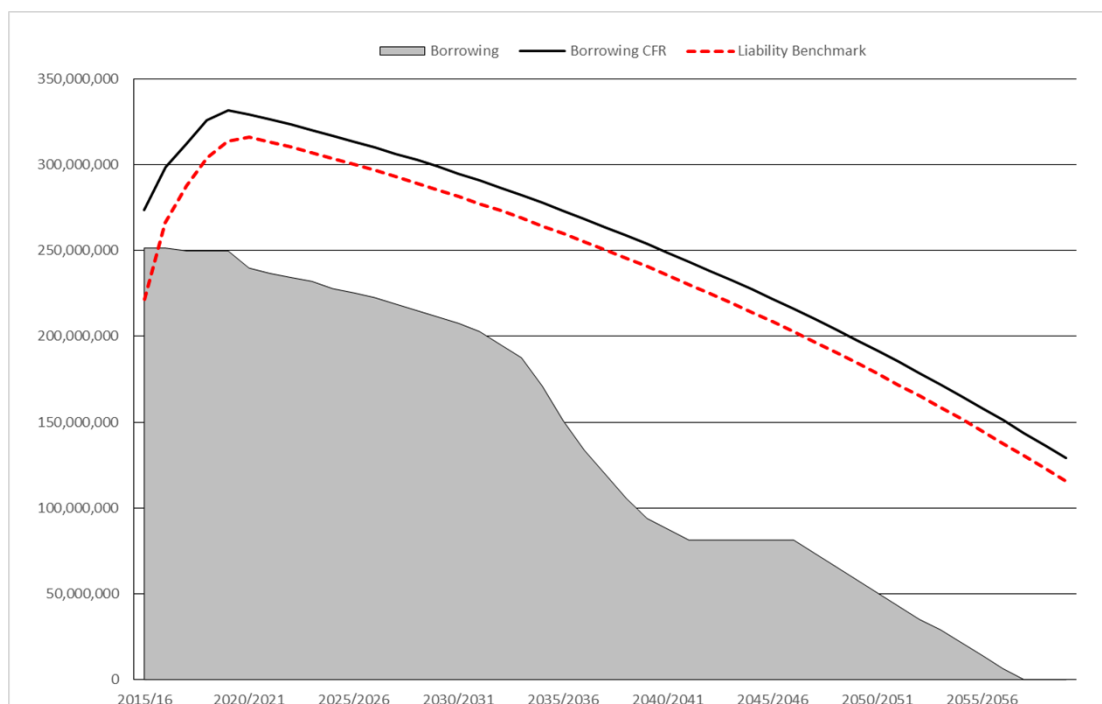
Table 3 shows the Authority's CFR increases during 2016/17, this is linked with the capital programme due to the 21st century schools building programme and the HRA capital programme which includes building new social housing and improving the existing stock to Welsh Housing Quality Standard (WHQS). The level of reserves the Authority has is expected to fall in 2016/17 as funding earmarked for specific purposes falls due for payment. The combination of the increase in capital expenditure and a reduction in reserves, results in:

- a reduction in investments in 2016/17 with further reductions expected in 2017/18
- a sustained requirement for new borrowing between 2016/17 and 2019/20

The graph in table 4 shows the Council's anticipated liability benchmark over the next 50 years, being the net requirement for borrowing after considering

resources available from reserves and working capital. The rise in the liability benchmark corresponds with the need to borrow to fund the increase in capital expenditure described above. The strategy in 2017/18, the same as in 2016/17, and over the medium term, is to ensure that any new borrowing undertaken does not exceed the liability benchmark and cause the council to borrow more than it needs.

Table 4: Liability Benchmark - Flintshire County Council (December 2016)



Budget implications

The budget for investment income in 2017/18 is £45k, based on an average investment portfolio of £15m at an average interest rate of 0.3%. The total budget for loan interest paid in 2017/18 is £13.2m, based on a debt portfolio of £287.8m at an average interest rate of 4.47%. If levels of investments, borrowing and interest rates differ from those forecast, performance against budget will be correspondingly different.

5.0 Investment Strategy

The Council holds surplus funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £15.1 and £67.1 million.

Both the CIPFA Code and the WG Guidance require the Council 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 Council'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.

Negative Interest Rates

If the UK enters into a recession in 2017/18, there is a very small chance that the Bank of England could set its Bank Rate at or below zero, which could feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. Although cash levels are decreasing, the Council could not avoid the need to occasionally invest funds in the short term for cash flow (liquidity) purposes, and therefore will be exposed to negative rates. This means that when an investment is returned at maturity, it will be less than originally invested as interest will be charged by the Counterparty rather than being paid. In this event, the aim will be to minimise investments and invest at the lowest negative rate.

Strategy

Given the increasing risk and falling returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2017/18 so far as cash liquidity requirements allow. This is especially the case if any medium to longer-term investments are made. The majority of the Authorities surplus cash is currently invested in short-term unsecured bank deposits and money market funds.

Investment criteria and limits

The Council may invest its surplus funds with any of the counterparties in the following table, subject to the monetary and time limits shown.

Table 5: Investment criteria and limits

(This table should be read in conjunction with the notes that follow it)

| Minimum Credit Rating | Banks Unsecured | Banks Secured | Government | Corporates | Registered Providers |
|------------------------------|------------------------|----------------------|-------------------------|-------------------|-----------------------------|
| UK Government | | | £ Unlimited 50 years | | |
| AAA | £2m 5 years | £2m 5 years | £2m 25 years | £2m 5 years | £2m 10 years |
| AA+ | £2m 4 years | £2m 4 years | £2m 15 years | £2m 4 years | |
| AA | £2m 3 years | £2m 3 years | £2m 10 years | £2m 3 years | |
| AA- | £2m 2 years | £2m 2 years | £2m 5 years | £2m 2 years | |
| A+ | £2m 1 year | £2m 1 year | | £2m 1 year | £2m 5 years |
| A | £2m 6 months | £2m 6 months | | £2m 6 months | |
| A- | | | | | |
| Pooled Funds | £3m per fund | | | | |

| | | | |
|----------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|--|
| BBB- | The Council is restricted to overnight deposits at its' own current account bank with a limit of £5m where the banks lowest credit rating is BBB+, BBB or BBB- (or equivalent) | | |
| Unrated Local Authorities | | £3m 2 years | |
| Unrated Other | The Council may invest in any other unrated organisation, subject to: <ul style="list-style-type: none"> • an external credit assessment and specific advice from the Authority's treasury management adviser (£1m each / 1 year limit) • a further policy framework for investing with any other organisations being developed (£100k each / 5 year limit) | | |

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

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. Unsecured investment with banks rated BBB are restricted to overnight deposits at the Authority's current account bank.

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 highest 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.

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.

Corporates

Loans, bonds and commercial papers 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 as part of a diversified pool in order to spread the risk widely.

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 Welsh Government or Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds

Shares in diversified investment vehicles consisting of the 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.

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.

Other Organisations

The Authority may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Authority's treasury management adviser.

Foreign countries

Investments in foreign countries will be limited to those that hold an AAA or AA+ / Aa1 sovereign credit rating from all three major credit rating agencies, and to a maximum of £5 million per foreign country. Investments in countries whose lowest sovereign rating is not AAA will be limited to one year's duration. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.

Risk assessment and credit ratings

The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc. and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is unlikely that the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

Credit ratings are obtained and monitored by the Council'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.

Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks.

Other information on the security of investments

The Council 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 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 above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council 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 Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office 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.

Specified investments

The WG 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”.

The Council defines ‘high credit quality’ organisations 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.

Non-Specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments in foreign currencies. 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; those that are defined as capital expenditure, such as money market funds and other pooled funds; and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in the table below.

Table 6: Non-Specified Investment Limits

| | Cash Limit |
|-----------------------------------------------------------------------------------------|------------|
| Total long-term investments | £5m |
| Total shares in pooled funds | £20m |
| Total investments without credit ratings or rated below A- (not including pooled funds) | £5m |
| Total non-specified investments | £30m |

Liquidity management

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council’s medium term financial plan and cash flow forecast.

Planned investment strategy for 2017/18

Treasury management staff will continue to seek out investments that meet the criteria detailed within this strategy whilst having full regard for the Council’s cash flow requirements.

The cash flow forecast will be used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Instant access money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks.

Cash that is not required to meet any liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local authority services. Security remains important, as any losses from defaults will impact on the total return, but fluctuations in price and even occasional losses can be managed over the long term within a diversified portfolio. Liquidity is of lesser concern, although it should still be possible to sell investments, with due notice, if large spending commitments arise unexpectedly. A wider range of instruments, including structured deposits, certificates of deposit, gilts and corporate bonds will be used to diversify the portfolio.

6.0 Borrowing Strategy

The Council currently holds £251.31m of long-term loans, as part of its strategy for funding previous years' capital programmes and HRA buy-out. The balance sheet forecast in section 4 shows that the Council expects to undertake new borrowing during 2017/18.

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which the funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

The Council's capital expenditure plans will be monitored throughout 2017/18 to inform and confirm the Council's long term borrowing need (figures in section 4 are an estimate). This is to ensure that the Council does not commit to long

term borrowing too early and borrow unnecessarily which will be costly. The use of short-term borrowing will assist with such. This will be balanced against securing low long term interest rates currently being forecast.

Given the significant cuts to public expenditure and in particular to local government funding, the Council'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 lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term instead.

By doing so, the Council is able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk, credit risk as a result of bail-in legislation in particular. The benefit of internal/short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when the long term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional costs in the short-term.

Whilst such a strategy is most likely to be beneficial in the short term as official interest rates are expected to remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing costs are forecast to rise.

Alternatively, the Authority may arrange forward starting loans during 2017/18, 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.

In addition, the Council may borrow for short periods of time (normally for up to one month) to cover unexpected cash flow shortages.

Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board (PWLB) and any successor body
- UK local authorities
- any institution approved for investments above
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the Clwyd Pension Fund)
- capital market bond investors
- Local Capital Finance Company (see below) and other special purpose companies created to enable joint local authority bond issues.

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

Municipal Bond Agency (Local Capital Finance Company)

The LGA Bond Agency is a Local Capital Finance Company 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 three reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the Authority and used to bolster the Agency's capital strength instead. Any decision to borrow from the Agency will therefore be the subject of a separate report to Cabinet.

LOBOs

The Authority holds £18.95m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as 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 2017/18, 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.

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 limit on the net exposure to variable interest rates in the treasury management indicators in section 9.

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 cost saving or a reduction in risk.

Planned borrowing strategy for 2017/18

The Corporate Finance Manager will:

- Manage the Council's debt maturity profile, i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing with the limits stated in this Strategy Statement. Appendix A analyses the debt portfolio of the Council, as at 31st December, 2016.
- Effect any borrowing that maybe required in 2017/18 at the cheapest cost commensurate with future risk based on interest rate forecasts.
- Monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movements, within the limits stated in this Strategy.
- Continue to monitor options for debt-restructuring and debt re-payment.

The Corporate Finance Manager will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions and actions taken under delegated powers to Cabinet via the Audit Committee.

The Council 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 bond issues and bank loans, that may be available at more favourable rates.

Loans that present additional risk to the authority, such as lender's option borrower's option (LOBO) loans and variable rate loans will be restricted to the limit on the net exposure to variable interest rates in the treasury management indicators in section 9.

7.0 Policy on Use of Financial Derivatives

In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

8.0 Policy on Apportioning Interest to HRA

The Council has adopted a single pool of loans which in part funds the capital expenditure of both Council Fund and HRA activities. The interest payable and other costs/income arising from long term loans (e.g. premiums and discounts on early redemption) is apportioned between the revenue accounts using the average Capital Financing Requirement (which measures the underlying need to borrow to fund capital expenditure) during the year.

Given that the HRA has minimal level of reserves compared to the total level of reserves held by the Council, any interest received on investments will be credited to the Council Fund revenue account.

9.0 Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators:

Interest rate exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

| | 2017/18 | 2018/19 | 2019/20 |
|-------------------------------------------------|---------|---------|---------|
| Upper limit on fixed interest rate exposures | £340m | £346m | £352m |
| Upper limit on variable interest rate exposures | £60m | £60m | £60m |

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity structure of borrowing

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

| | Lower | Upper |
|---------------------------------|-------|-------|
| Under 12 months | 0% | 10% |
| 12 months and within 24 months | 0% | 10% |
| 24 months and within five years | 0% | 30% |
| Five years and within 10 years | 0% | 50% |
| 10 years and above | 0% | 100% |

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.

Principal sums invested for periods longer than 364 days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long term principal sum invested to final maturities beyond the period end will be:

| | 2017/18 | 2018/19 | 2019/20 |
|---------------------------------------------------|---------|---------|---------|
| Limit on total principal invested beyond year end | £5m | £5m | £5m |

Any long term investments carried forward from previous years will be included in each years limit.

Borrowing limits

The Council is being asked to approve these Prudential Indicators as part of the Capital Programme report. However they are repeated here for completeness.

| | 2017/18 | 2018/19 | 2019/20 |
|----------------------------------------------------|-------------|-------------|-------------|
| Operational boundary – borrowing | £320m | £326m | £332m |
| Operational boundary – other long-term liabilities | <u>£20m</u> | <u>£20m</u> | <u>£20m</u> |
| Operational boundary – TOTAL | £340m | £346m | £352m |
| Authorised limit – borrowing | £340m | £346m | £352m |
| Authorised limit – other long-term liabilities | <u>£35m</u> | <u>£35m</u> | <u>£35m</u> |
| Authorised limit – TOTAL | £375m | £381m | £387m |

10.0 Other Matters

The WG Investment Guidance requires the Council to note the following three matters each year as part of the investment strategy:

Treasury Management Advisers

The Council's treasury management adviser, Arlingclose continues to provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is controlled by Financial Procedure Rules

Investment training

The needs of the Council'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 Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

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.

The total amount borrowed will not exceed the authorised borrowing limit of £380 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.

Other Options Considered

The WG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Finance Manager believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed in the following table.

| Alternative | Impact on income and expenditure | Impact on risk management |
|--------------------------------------------------------------------------|------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| Invest in a narrower range of counterparties and/or for shorter periods. | Interest income will be lower | Reduced risk of losses from credit related defaults |
| Invest in a wider range of counterparties and/or for longer periods. | Interest income will be higher | Increased risk of losses from credit related defaults |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain |
| Reduce level of borrowing if debt rescheduling costs weren't prohibitive | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain |

APPENDIX A – DEBT MATURITY PROFILE

