PETERBOROUGH
CITY COUNCIL

Treasury Management Strategy 2018/19 to 2020/21

Including:
Minimum Revenue Provision Policy 2017/18 and 2018/19

1. Introduction

1.1. Background

1.1.1. The Council is required to operate a balanced budget, which means that cash raised through the year will meet its cash expenditure. The Treasury Management Strategy (TMS) has four fundamental roles:

- Manage External Investments - Security, Liquidity and Yield
- Ensure Debt is Prudent and Economic
- Produce and Monitor the Prudential Indicators
- To ensure that decisions comply with regulations.

1.1.2. The role of treasury management is to ensure cash flow is adequately planned so that cash is available when it is needed. Surplus monies are invested in low risk counterparties commensurate with the Council's low risk appetite ensuring that security and liquidity are achieved before considering investment return.

1.1.3. Another role of treasury management is to fund the Council's capital programme. The programme provides a guide to the borrowing needs of the Council and the planning of a longer term cash flow to ensure capital obligations are met. The management of long term cash may involve arranging short or long term loans or using longer term cash flow surpluses.

1.1.4. CIPFA defines treasury management as:

" The management of the local authority's investments and cash flows, its 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."

1.1.5. The Treasury Management Strategy also fulfils part of the requirements of the Ministry of Housing Communities and Local Government (MHCLG) for every local authority to produce an Annual Investment Strategy (AIS). The AIS is a separate Report to the TMS.

1.2. Reporting Requirements

1.2.1. The Council is required to receive and approve, as a minimum, three reports each year. These reports are to be scrutinised by the Audit Committee before being recommended to Council.

1.2.2. This Treasury Management Strategy report 2018/19 covers:

- the capital programme (including prudential indicators)
- a Minimum Revenue Provision (MRP) Policy
- the Treasury Management Strategy including treasury indicators; and
- an Investment Strategy

1.2.3. A mid-year Treasury Management Report will update members of the Audit Committee with the progress of the capital programme, investments and amending prudential indicators as necessary.

1.2.4. An Annual Treasury Report will provide details of actual prudential and treasury indicators and actual treasury operations compared to estimates. The Annual Treasury Report is presented alongside the Statement of Accounts.

1.2.5. Any revisions to the Treasury Management Strategy will need to be approved by Full Council.

1.3. **Treasury Management Strategy for 2018/19**

1.3.1. The strategy for 2018/19 covers:

- Policy on use of External Advisors - Section 1.4
- Treasury Management Policy Statement - Section 1.5
- Revised CIPFA Treasury Management and Prudential Codes - Section 1.6
- Treasury Management role of the S151 Officer Roles - Section 1.7
- Capital Programme and the Prudential Indicators - Section 2
- Minimum Revenue Provision Policy - Section 3
- Current Treasury Position - Section 4
- Treasury Indicators - Section 4
- Prospects for Interest Rates - Section 5
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- Borrowing Strategy - Section 7
- New Borrowing Approaches to be Considered – Section 8
- Treasury Debt Prudential Indictors - Section 9
- Policy on Borrowing in Advance of Need - Section 10
- Debt Rescheduling - Section 11
- Municipal Bond Agency - Section 12
- Investment Strategy - Section 13
- Creditworthiness Policy - Section 14
- Loans made to Third Parties - Section 15
- Non-financial Investments - Section 16
- Treasury Management Scheme of Delegation - Section 17

1.3.2. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code 2017, the MHCLG, MRP Guidance, the CIPFA Treasury Management Code 2017 and the MHCLG Investment Guidance.

1.4. **Treasury Management Advisors**

1.4.1. The Council uses Link Asset Services (previously Capita Asset Services) as its external treasury management advisors who have a contract until September 2018.

1.4.2. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon external advisors.

1.4.3. The Council also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources. The Council 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.

1.5. **Treasury Management Policy Statement**

1.5.1. The Treasury Management Policy Statement sets out the policies and objectives of Treasury Management Activities which is revised annually. It reflects December 2017 guidance.

1.5.2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

1.5.3. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.5.4. Investments using the above definition cover all financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework.

1.5.5. The Council's high level policies for borrowing and investments are set out below.

- To invest available cash balances with a number of high quality investment counterparties over a spread of maturity dates in accordance with the Council's lending list;
- To reduce the revenue cost of the Council's debt in the medium term by obtaining financing at the cheapest rate possible;
- To seek to reschedule or repay debt at the optimum time**.**

1.6. Revised CIPFA Treasury Management and Prudential Codes

1.6.1. CIPFA has reviewed the Treasury Management Code of Practice and the Prudential Code. This review focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases may involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions affect treasury management.

1.6.2. CIPFA has withdrawn some prudential indicators (listed below) as they have caused confusion as to how to calculate them. However it is appropriate to retain these as local Peterborough indicators because they are highly relevant to measuring the sustainability of the Council's long term financial position.

1.6.2.1. Estimates of the ratio of financing costs as a percentage of net revenue stream for three years ahead

1.6.2.2. Actual ratio of financing costs to net revenue stream (after the year-end)

1.6.2.3. Q4 of the Prudential Code consultation questionnaire also questioned whether HRA indicators should be removed. This will not affect the Council as it is not an HRA Council

1.6.3. The requirement to report on investments of longer than 364 days has been changed to longer than 365 days. This change has been incorporated into Indicator 11.

1.7. The Treasury Management Role of the Section 151 Officer

The S151 (responsible) officer must do the following:

- recommend clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submit regular treasury management policy reports;
- submit budgets and budget variations;
- receive and reviewing management information reports;
- review the performance of the treasury management function;

- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority. This is done by regular training presentations to the Audit Committee;
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above. This is done by regular attendance at course and conferences and joint working with Link Asset Services;
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following -

    Risk management (Treasury Management Practise 1 (TMP) and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;

    Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

    Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

    Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken to the various committees;

Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

2. Capital Prudential Indicators 2018/19 to 2020/21

2.1. The Council's capital programme is the key driver of the treasury management activity. The output of the capital programme is reflected in the prudential indicators which are designed to assist member's overview and confirm the capital programme.

2.2. **Indicator 1** – Capital Expenditure – this Prudential Indicator is a summary of the Council's estimated capital expenditure for the forthcoming financial year and the following two financial years including how it will be funded either from grants, contributions, or capital receipts with the remaining being the 'net financing requirement'

Capital Expenditure	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
Growth & Regeneration	23.9	32.0	48.9	25.4	12.5
People & Communities	27.6	38.5	55.6	50.8	14.4
Resources	6.2	11.2	2.4	1.9	2.0
Invest to Save/Cost Avoidance Schemes	19.1	16.6	43.4	35.0	10.0
Total	**76.8**	**98.3**	**150.3**	**113.1**	**38.9**
Financed by:					
Capital receipts	1.0	1.1	24.2	15.0	0.0
Capital grants contributions	35.9	39.3	32.2	32.1	7.1
Net financing requirement	**39.9**	**57.9**	**93.9**	**66.0**	**31.8**
Total	**76.8**	**98.3**	**150.3**	**113.1**	**38.9**

2.3. The capital receipts shown in the tables for future years relate to the following:

- 2016/17 - Local Authority Mortgage Scheme (LAMS) capital loan - £1m
- 2017/18 - Fletton Quays capital receipt - £1.1m
- 2018/19 - Local Authority Mortgage Scheme (LAMS) capital loan - £1m
- 2018/19 – ECS Peterborough 1LLP – capital loan - £23.2m
- 2019/20 – Norlin – capital loan - £15m

2.4. The Invest to Save/Cost Avoidance schemes are included in the tables that detail total capital expenditure and the funding resources to be used. However, these schemes will either generate income or generate savings on revenue budgets elsewhere in the Council's services. Therefore the borrowing costs associated with these projects will have a minimal impact on the Council's MTFS position.

2.5. **Indicator 2** – Capital Financing Requirement (CFR) – the CFR is the total historical capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing requirement. Any capital expenditure which has not immediately been paid for will increase the CFR.

2.6. The current position for the Council is that it does not reduce its total debt outstanding. As the Council continues to invest in the City it will increase the CFR. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) included on the Council's balance sheet following the IFRS conversion in 2010/11. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The following table shows the CFR estimates for the next three financial years:

Capital Financing Requirement	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
CFR brought forward	480.9	509.8	555.4	636.2	688.1
Borrowing/Repayment	9.8	29.0	37.4	16.9	7.0
Invest to Save*	19.1	16.6	43.4	35.0	10.0
CFR carried forward	509.8	555.4	636.2	688.1	705.1
Movement in CFR	**28.9**	**45.6**	**80.8**	**51.9**	**17.0**
Net financing requirement	39.9	57.9	93.9	66.0	31.8
Less MRP & other financing	(11.0)	(12.3)	(13.1)	(14.1)	(14.8)
Movement in CFR	**28.9**	**45.6**	**80.8**	**51.9**	**17.0**

2.7. The difference between the borrowing requirement and the movement on the CFR is the MRP recharge made during the year.

2.8. **Indicator 3** – Actual and estimates of the ratio of financing costs to net revenue budget. This indicator identifies the proportion of the revenue budget which is taken up in Financing capital expenditure i.e. the net interest cost and the provision to repay debt.

Ratio of gross financing costs to net revenue budget	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
Total ratio	**6.1%**	**6.2%**	**5.4%**	**7.3%**	**9.2%**

3. Minimum Revenue Provision Policy

3.1. Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, equipment, etc. Such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP).

3.2. CLG Regulations require full Council to approve an MRP statement in advance of each year. A variety of options are provided to Councils to calculate this revenue charge and the Council must satisfy itself that the provision is prudent.

3.3. Councils are allowed by statute to use capital receipts for the repayment of any borrowing previously incurred. The application of capital receipts to repay debt would reduce the level of MRP chargeable to revenue, but statutory guidance does not address how such a reduction should be calculated. When the Council uses its capital receipts to redeem borrowing, the value of the MRP which would otherwise have been set aside for that year will be reduced by the amounts which have instead been repaid from capital receipts. This results in a prudent level of MRP, as there will be no reduction in the overall level of funding set aside to redeem debt.

3.4. The Council participates in the Local Authority Mortgage Scheme (LAMS). Such deposits are treated as capital expenditure, as a loan to a third party. The CFR increased by the total of these indemnities. Operation of the Scheme sees these deposits returned in full at maturity, after a period of five years, with interest paid annually. As this is a temporary five year arrangement and the funds are anticipated to be returned in full, there is no MRP application.

3.5. Once the deposit matures, and funds are returned to the Council, the funds are classed as a capital receipt (as it is a loan) and the CFR will reduce accordingly.

3.6. Repayments for PFI scheme and finance leases are applied as MRP, and the associated amounts are included in these Prudential Indicators.

3.7. Below is a table summarising the MRP Policy adopted in 2016/17.

<table>
<tr><th colspan="2">Summary of MRP Policy</th></tr>
<tr><th>Capital Expenditure Incurred</th><th>MRP Policy 2017/18 & 2018/19</th></tr>
<tr><td>Pre 2007/08 debt
(ie debt up to 31.03.2007)</td><td rowspan="2">Use the annuity method of calculation over an average weighted asset life</td></tr>
<tr><td>Supported Borrowing post 2007/08</td></tr>
<tr><td>Unsupported borrowing 2007/08 & 2008/09</td><td>Use the annuity method of calculation over the remaining asset life</td></tr>
<tr><td>Unsupported borrowing
Post 2008/09</td><td>Charged in relation to asset life on annuity method</td></tr>
<tr><td>Private Finance Initiative (PFI) - Finance Lease</td><td>Use the annuity method of calculation over the remaining asset life</td></tr>
<tr><td>Other Finance Leases</td><td>Charged in relation to asset life on annuity method</td></tr>
<tr><td>Expenditure funded by unsupported borrowing reflected within the debt liability after the 31 March 2010</td><td>Asset Life Method, annuity method – MRP will be based on the prevailing PWLB interest rate for a loan with a term equivalent to the estimated life of the project.

If capital receipts have been used to repay borrowing for the year then the value of MRP which would have otherwise been set aside to repay borrowing will be reduced by the amounts which have instead been repaid from capital receipts. The level of capital receipts to be applied to redeem borrowing will be determined annually by the Corporate Director Resources, taking into account forecasts for future expenditure and the generation of further receipts.

The same process will apply for S106, POIS and CIL receipts.</td></tr>
</table>

Secured Loans to third parties repaid in bullet form.	No MRP will be charged each year as reliance can be placed on the capital receipt that will be generated when the loan is repaid or, in the event of a default, the realisation of the security

4. Current Treasury Position

4.1. **Indicator 4** - The Council's treasury position at 31 March 2017, with estimates for future years, is summarised below. The table below shows the actual external borrowing (Gross Debt) against the CFR.

Gross debt & capital financing requirement	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
External Borrowing					
Market Borrowing	363.1	395.4	441.0	522.0	573.5
Repayment of borrowing	-	(18.8)	(12.0)	(28.0)	(17.5)
Expected change in borrowing	32.2	64.3	93.0	79.9	34.4
Other long-term liabilities	35.6	37.7	36.8	36.3	35.8
Gross Debt at 31 March	**430.9**	**478.6**	**558.8**	**610.2**	**626.2**
CFR	509.8	555.4	636.2	688.1	705.1
% of Gross Debt to CFR	**84.5%**	**86.2%**	**87.8%**	**88.6%**	**88.9%**

4.2. Based on the prudential indicators there are a number of key measures to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its total borrowing does not, except in the short term, exceed the total of the CFR in the year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

4.3. The Interim Corporate Director: Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the proposals in this MTFS.

4.4. **Indicator 5** - The Operational Boundary - external borrowing is not normally expected to exceed this limit. If the operational boundary was exceeded this would be reported immediately to the members of the Audit Committee with a full report taken to the next committee meeting. In the current year it has not been exceeded. The Operational Boundary is set out below:

Operational Boundary	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
Borrowing	395.3	524.5	659.7	677.1	653.5
Other long term liabilities	35.6	37.7	36.8	36.3	35.8
Total	**430.9**	**562.2**	**696.5**	**713.4**	**689.3**

4.5. **Indicator 6** - The Authorised Limit for external borrowing - this represents a limit beyond which external borrowing is prohibited. This limit is set and revised by full Council.

Authorised Limit	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
Borrowing	395.3	572.2	706.5	723.4	699.4
Other long term liabilities	35.6	37.7	36.8	36.3	35.8
Total	**430.9**	**609.9**	**743.3**	**759.7**	**735.2**

4.6. This is a statutory limit determined under section 3 (1) of the Local Government Act 2003. Government under sections 4(1) and 4(2) may limit either the total of all Council borrowing, or those of a specific Council, although this power has not yet been exercised.

5. Prospects for Interest Rates

5.1. The Council utilises the treasury services of Link Asset Services and part of their service is to assist the Council to formulate a view on interest rates to assist with borrowing and investment decisions.

5.2. The Link Asset Services forecast for bank base rate (as at November 2017) and PWLB new borrowing (as at November 2017) is as follows (note that the PWLB Borrowing Rate includes the Certainty Rate adjustment):

<table>
<tr><th>Interest Rate (All rates shown as %)</th><th>Bank Rate View</th><th>5yr PWLB Rate</th><th>10yr PWLB Rate</th><th>25yr PWLB Rate</th><th>50yr PWLB Rate</th><th>Budget Assumption</th></tr>
<tr><td>Now</td><td>0.50</td><td>1.50</td><td>2.10</td><td>2.80</td><td>2.50</td><td rowspan="2">2.60</td></tr>
<tr><td>Mar 18</td><td>0.50</td><td>1.60</td><td>2.20</td><td>2.90</td><td>2.60</td></tr>
<tr><td>Jun 18</td><td>0.50</td><td>1.60</td><td>2.30</td><td>3.00</td><td>2.70</td><td rowspan="4">2.90</td></tr>
<tr><td>Sep 18</td><td>0.50</td><td>1.70</td><td>2.40</td><td>3.00</td><td>2.80</td></tr>
<tr><td>Dec 18</td><td>0.75</td><td>1.80</td><td>2.40</td><td>3.10</td><td>2.90</td></tr>
<tr><td>Mar 19</td><td>0.75</td><td>1.80</td><td>2.50</td><td>3.10</td><td>2.90</td></tr>
<tr><td>Jun 19</td><td>0.75</td><td>1.90</td><td>2.60</td><td>3.20</td><td>3.00</td><td rowspan="4">3.15</td></tr>
<tr><td>Sep 19</td><td>0.75</td><td>1.90</td><td>2.60</td><td>3.20</td><td>3.00</td></tr>
<tr><td>Dec 19</td><td>1.00</td><td>2.00</td><td>2.70</td><td>3.30</td><td>3.10</td></tr>
<tr><td>Mar 20</td><td>1.00</td><td>2.10</td><td>2.70</td><td>3.40</td><td>3.20</td></tr>
<tr><td>Jun 20</td><td>1.00</td><td>2.10</td><td>2.80</td><td>3.50</td><td>3.30</td><td rowspan="4">3.35</td></tr>
<tr><td>Sep 20</td><td>1.25</td><td>2.20</td><td>2.90</td><td>3.50</td><td>3.30</td></tr>
<tr><td>Dec 20</td><td>1.25</td><td>2.30</td><td>2.90</td><td>3.60</td><td>3.40</td></tr>
<tr><td>Mar 21</td><td>1.25</td><td>2.30</td><td>3.00</td><td>3.60</td><td>3.40</td></tr>
</table>

5.3. The Council successfully applied to be one of the principal local authorities that would qualify for the Certainty Rate, during the period 1 November 2017 to 31 October 2018. This results in the Council being able to benefit from reduced interest rates on PWLB loans by 20 basis points (0.20%). The Council is assuming that there will be a similar scheme in place when this scheme expires. The Council will submit a new application to ensure it qualifies.

5.4. The MTFS assumes borrowing is taken at the 50 year period with an average taken across the quarters for that year but then adjusted with a range of borrowing periods and associated interest rates. The Chief Finance Officer believes this prudent as it mitigates some of the risk of PWLB rate rise.

5.5. Link Asset Services interest rate forecasts, detailed above, are based on their views of the future economic climate, and below are some extracts taken from their economic forecasts:

- As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.
- 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 more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to 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 in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.
- 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 stronger economic growth becomes more firmly established. The Fed has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will 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 are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, 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 towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.
- From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.
- 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 balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.
- Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:
- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Germany is still without an effective government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March and the anti EU populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the EU as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- The October 2017 Austrian general election has returned a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries
- The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

6. Investment and Borrowing Rates

6.1. Investment returns are likely to remain low during 2018/19 but will be on a rising trend over the next few years.

6.2. Borrowing interest rates increased sharply after the result of the general election in June 2017 and then also after the September 2017 MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little change in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

6.3. There will remain a cost of carry to any new long-term borrowing that temporarily increases cash balances. This revenue cost is the difference between borrowing costs and investment returns.

7. Borrowing Strategy

7.1. The Council is currently maintaining an under-borrowed position, where CFR balance is greater than gross debt, see Indicator 2. This is in line with the agreed strategy that the Council's cash balances be used to fund capital expenditure before additional borrowing is undertaken. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

7.2. The capital programme consists of three main types of capital projects:

- Invest to Save – Self Funding Schemes
- Specific Schemes – eg School Extensions
- Rolling Capital Projects eg Enhancing current assets

7.3. Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Interim Corporate Director: Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

7.4. Any borrowing decisions will be reported to the appropriate decision making body at the next available opportunity.

7.5. The MTFS is based on the following borrowing strategy for the next three years. The borrowing strategy is under constant review throughout the year monitoring changes in interest rates and borrowing opportunities. The proposed strategy for 2018/19 financial year is:

a) To consider the rescheduling (early redemption and replacement) of loans to maximise interest rate savings and possible redemption discounts.

b) Significant risk of a sharp fall in long and short term rates may arise. This might be due to a marked increase of risks around relapse into recession or of risks of deflation. In this case long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

c) Significant risk of a much sharper rise in long and short term rates than currently forecast may arise. This may arise due to a greater than expected increase in world economic activity or a sudden increase in inflation risks. In this case the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

d) Loans will primarily be arranged from the PWLB and other Local Authorities.

e) To maintain an appropriate balance between PWLB, Local Authority and other market debt in the debt portfolio and a balance in the maturity profile of debt.

f) To give full consideration to other debt instruments e.g. Local Authority Bonds as an alternative to PWLB borrowing. Due regard will be given to money laundering regulations. The Council is monitoring the development of the scheme and may participate if this proves beneficial.

8. New Borrowing Approaches to Be Considered:

8.1. To achieve a more even spread of loan maturities so that there is not an exceptional borrowing requirement in any future year. Rebalancing the current uneven profile will potentially allow interest savings given the current yield curve. Currently under 10 year money and over 35 year money is historically at a low interest cost.

8.2. Maturing long term debt is replaced by new borrowing. To achieve long term financial sustainability the Council should aim to reduce its overall debt and the associated financing costs including interest. A high value of outstanding debt represents a financial risk because of potential interest rate changes.

8.3. The use of Capital receipts or S106 receipts to make minimum revenue provision is a one-off revenue saving. Using these funds in this way means they are not available to fund Capital assets and reduce the overall borrowing requirement.

8.4. Interest rates are liable to change. In the event of significant changes the Council seeks to avoid an increased revenue cost on its capital financing charges.

8.5. The Treasury Management Strategy uses the planned Capital Programme to calculate the borrowing requirement. Typically the Council does not spend at the planned level in any financial year.

8.6. Link Asset Services have a product that will allow the Council to borrow from the market at current interest rates with a small premium but not draw down the funds until they are required - 'forward borrow'.

9. Treasury Debt Prudential Indicators

9.1. There are three debt treasury indicators which ensure debt structure remains within appropriate limits. This manages risk and reduces the impact of any adverse movement in interest rates.

9.2. **Indicator 7** – Upper limit on fixed interest rate exposure. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments. This has been set at 100% of the borrowing requirement.

9.3. **Indicator 8 -** Upper limit on variable rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. This has been set at 25% of the borrowing requirement.

Interest Rate Exposure (Upper Limits)	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
(7) Limits on fixed interest rate net debt	416.3	534.5	669.7	687.1	663.5
% of fixed interest rate exposure	100%	100%	100%	100%	100%
(8) Limits on variable interest rate on net debt	104.1	133.6	167.4	171.8	165.9
% of variable interest rate exposure	25%	25%	25%	25%	25%

9.4. **Indicator 9** - Maturity structure of borrowing. These gross limits are set to reduce the Council's immediate exposure to large fixed rate sums falling due for refinancing.

Maturity Structure of borrowing	**Upper Limit**
Under 12 months	40%
12 months to 2 years	40%
2 years to 5 years	80%
5 years to 10 years	80%
10 years and above	100%

10. Policy on Borrowing in Advance of Need (Future Capital Expenditure)

10.1. The Council will not borrow more than it requires, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. However, at any time the Council may obtain a loan or other financing at what are considered advantageous terms in anticipation of future capital expenditure. The money borrowed will be invested temporarily. The Council may also borrow in the day-to-day management of its cash flow operations or as an alternative to redeeming higher yielding investments.

10.2. Any decision to borrow in advance of need will be within the CFR limits, and will be considered carefully to ensure value for money.

10.3. The Council will ensure there is a clear link between the capital programme across the future years and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of capital expenditure.

10.4. The Council will ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered and factored into the MTFS.

10.5. Consideration will be given to the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

11. Debt Rescheduling on Existing Debt Portfolio

11.1. Short term borrowing rates are forecast to be considerably cheaper than longer term fixed interest rates. There may be potential to generate savings by switching existing long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of debt repayment (premiums incurred). Debt rescheduling will only be carried out on the existing debt portfolio. Future borrowing will be carried out as per this strategy and over shorter periods of time.

12. Municipal Bond Agency

12.1. It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Council may make use of this new source of borrowing as and when appropriate.

13. Investment Strategy Principles

13.1. The Council does not borrow specifically for the purpose of making investments.

13.2. The Council has not made any non-financial investments. A revised strategy will be put forward to Full Council for consideration before any non-financial investments are undertaken.

14. Investment Counterparty Selection Criteria and Financial Investment Strategy

14.1. As the Council has run down its cash balances, surplus cash will be generated from cash flow movements e.g. a grant received in advance of spend or from borrowing in advance of need. Therefore investment activity will be kept to a minimum.

14.2. However, where it is necessary for investments to be undertaken in order to manage the Council's cash flows, the Council's primary principle is for the security of its investments. After this main principle the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

14.3. The Interim Corporate Director: Resources will maintain a counterparty list in compliance with the set out below. Any revision of the criteria will be submitted to Council for approval as necessary.

14.4. The Councils minimum criteria will apply to the lowest rating for any institution according to the type of investment account being used. For instance, the credit rating criteria for the use of the Council's call accounts and Money Market Funds, which are used for short term investments only, will use the Short Term credit ratings in the table shown within 14.6 if an institution is rated by the three credit agencies and two meet the Council's criteria and the other one does not, the institution will fall outside the lending criteria. This complies with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

14.5. In order to minimise the risk to investing, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The Council uses the creditworthiness service provided by Link Asset Services which uses ratings from all three rating agencies, Fitch, Moody's and Standard and Poor's, as well as Credit Default Swap (CDS) spreads. Link Asset Services monitors ratings on a real time basis and notifies clients immediately on any rating changes or possible downgrades.

14.6. Minimum Credit Ratings Criteria – further explanations are given in Appendix 1

Minimum Credit Ratings for Group 2 Banks		
Agency	**Short Term**	**Long Term**
Fitch	F1	A
Moody's	P-1	Aa
Standard & Poor's	A-1	A

14.7. All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three rating agencies by Link Asset Services

14.8. The Council does not place sole reliance on the use of Link Asset Service's advice as the Council uses internal expertise and knowledge to make decisions. Market data, market information, information on government support for banks and the credit ratings of that government support are also considered when making treasury decisions.

14.9. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-Specified investments), and is shown in the order of use by the Council, as follows:

- UK Government (including gilts and the Debt Management Account Deposit Facility (DMADF)).
- Bank of Scotland call account (part of the Lloyds Banking Group).
- UK Local Authorities.
- All of the above would be subject to continuous credit rating reviews

14.10. The Council also uses Barclays Bank, the Council's own banker. If Barclays fall below the criterion in 14.6 then the following strategy will be followed:

With regard to the three credit rating agencies, if one reduces it's rating but the other two remain the same or improve, no action will be taken with regards to funds held with Barclays, ie maximum of £5m in the call account

If two or more credit rating agencies reduce their ratings only, as the Council will still require to use the Barclays accounts for transactional purposes, a maximum balance of £500k will be left overnight to prevent the account becoming overdrawn and incurring overdraft fees

Seek advice from Link Asset Services

14.11. The above action applies to Barclays only due to its status as the Council's banking provider. Use of other bank accounts would be subject to criteria set out in the point above. The above approach to Barclay's Bank has been developed following consideration of that the Council needs banking facilities to process daily banking transactions, and such activity presents a lower risk profile compared to investment activity the significant impact, resource requirement, and risk exposure of changing bank provider the possible state and stability of the banking sector and viable alternative suppliers.

14.12. Local Authority Mortgage Scheme. Under this scheme the Council had placed funds of £2m with Lloyds Bank for a period of five years. The first tranche of £1m has matured and been returned to the Council, leaving £1m still on deposit. This is classified as being an indemnity arrangement and therefore accounted for as a capital expenditure transaction, rather than a treasury management investment. Therefore LAMS is outside the Specified/Non specified categories but is included in this Strategy for completeness. Any other counterparty used will fall outside the Specified/Non specified categories as per the reason stated above. Therefore the minimum credit criteria need not apply to the LAMS scheme.

- Banks Group 1 - Part nationalised UK banks - Lloyds Banking Group Plc. (Bank of Scotland and Lloyds) and Royal Bank of Scotland Group Plc. (National Westminster Bank, The Royal Bank of Scotland and Ulster Bank Ltd). These banks can be included if they continue to be part nationalised and / or they meet the ratings in 14.6.
- Banks Group 2 – good credit quality - the Council will only use banks which are UK banks and have the minimum credit ratings criteria relating to the type of investment being undertaken.

- Building Societies – if they meet the ratings above
- Money Market Funds - AAA rated by Fitch
- Bill Payment Service – The Council currently has a contract with Santander UK who collect payments of Council Tax through the post office via various methods of payment such as Paypoint. The funds that are collected are transferred to the Council daily thus minimising the risk of Santander UK holding the Council's cash. This arrangement for the bill payment service falls outside the investment criteria for investments therefore any downgrade of Santander UK will not affect this service. However this arrangement will be closely monitored to ensure funds continue to be transferred daily.

14.13. The Council's lending list will comprise of the institutions that meet the investment criteria above. Each counterparty on the list is assigned a counterparty limit as per the table in Appendix 1. Counterparties that no longer meet the investment criteria due to a credit rating downgrade will be removed from the list and any changes will be approved by Council. Resources. Approval will also be required if any new counterparties are added to the lending list.

14.14. Link Asset Services approach to assessing creditworthiness of institutions is by combining credit ratings, credit watches and credit outlooks to produce a colour coding system. The Council will use counterparties within the following maximum maturity periods, in order to mitigate the risk of investing in these institutions:

Link Asset Services Banding	Description
Blue	1 year (only applies to nationalised / semi nationalised UK banks)
Orange	1 year
Red	6 months
Green	3 months
No colour	The Council will not invest with these institutions

14.15. The proposed criteria for Specified and Non-Specified investments are shown in Appendix 1 for approval.

14.16. **Indicator 11** - Upper limit for total principal sums invested for over 365 days excluding loans. This limit is set with regard to the Council's liquidity requirements and to reduce the need for an early sale of an investment, and is based on the availability of funds after each year-end and up-dates are reported to the Audit

14.17. Committee at midyear.

Overall limit for sums invested over 365 days	16/17 Actual £m	17/18 Est £m	18/19 Est £m	19/20 Est £m	20/21 Est £m
Principal sums invested 365 days	**1.0**	**10.0**	**10.0**	**10.0**	**10.0**

15. Loans Made to Third Parties

15.1. The Council makes secured loans to third parties to advance the Council's strategic interests.

15.2. Loans are only made after the Council's formal decision making process has been followed. This includes formal approval by the Corporate Director: Resources.

15.3. As part of the formal decision to make the loan, the security for the loan will be assessed as to its adequacy in the event of the third party defaulting on repayment.

15.4. The Council have approved the secured capital loans to three third parties which are Axiom Housing Association (Council - 8 October 2014), ECS Peterborough 1 LLP (Council - 17 December 2014) and the Housing Joint Venture (Jul 2016). These are set out in the table below.

Third Party Details	Current Loan Advanced	Maximum Exposure
Longhurst Housing Association (previously Axiom)	Capital Loan £0.5m Capital Loan £6.7m	£30m
ECS Peterborough 1 LLP	Capital Loan £23.2m	£23.5m
Affordable Housing	Nil	Not Agreed
Norlin Loan	Nil	£15m

15.5. Individual loan agreements provide for the recovery of the capital loan in the event of a default.

16. Non-financial investments

16.1. The Council does not hold any non-financial investments whose purpose is to generate revenue to support core services.

17. Treasury Management Scheme of Delegation

17.1. The following is a list of the main tasks involved in treasury management and who in the Council is responsible for them:

Full Council / Audit Committee

- Receiving and reviewing reports on treasury management policies, practices and activities.
- Approval of Annual Strategy.

Audit Committee / S151 Officer (Corporate Director: Resources)

- Approval of / amendments to the Council's adopted clauses, Treasury Management Policy Statement and Treasury Management Practices.
- Budget consideration and approval.
- Approval of the division of responsibilities.
- Receiving and reviewing regular monitoring reports and acting on recommendations.

Section 151 Officer (Executive Director Resources) / Service Director Financial Services / Head of Corporate Finance

- Reviewing the Treasury Management Policy and procedures and making recommendations to the responsible body.
- Recommending clauses, treasury management policy/practices and making recommendations to the responsible body.
- Submitting regular treasury management reports.

- Submitting budgets and budget variations.
- Receiving and reviewing management information reports.
- Reviewing the performance of the treasury management function.
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- Ensuring the adequacy of internal audit, and liaising with external audit.
- Recommending the appointment of external service advisors

Specified Investment Credit Criteria and Limits
Specified Investment:

- Offer high perceived security such as placements with Central Government Agencies, Local Authorities or with organisations that have strong credit ratings
- They offer high liquidity i.e. short term or easy access to funds
- Are denominated in £ sterling
- Have maturity dates of no more than 1 year
- For an institution scheme to qualify as a 'Specified Investment' it must have a minimum rating (see Section 14.6)

Investment Type	Maximum Maturity Period	Minimum Credit Criteria	Collective Limit £m	Individual Limit £m
Deposit accounts with regulated UK Banks and UK Building Societies	Repayable on call, without notice	Minimum of two short term rating criteria	100	15
Money Market Funds repayable on call, no notice	Call	Minimum rating – AAA (Fitch)	50	10
Debt Management Agency Deposit Facility	6 months currently	UK Government backed	N/A	75
Term Deposits UK Government & Local Authorities	Maturities of up to 1 year	Sovereign risk high security not credit rated	100	20
Term Deposits & Certificates of Deposit Banks Group 1	Maturities of up to 1 year	Minimum of three short term rating criteria	100	75
UK Government & Local Authority Stock Issues	Maturities of up to 1 year	Sovereign risk high security not credit rated	100	20
Term deposits & Certificates of Deposit Banks Group 2	6 months	Minimum of three short term rating criteria	50	10
Forward Term Deposits with Regulated UK Banks	Maturities of up to 1 year	Minimum of three short term rating criteria	100	15

Non-specified Investment Credit Criteria and Limits

- With the same institutions classified as “specified” investments but have maturity dates in excess of one year, or
- Are offered by organisations that are not credit rated or the credit rating does not meet the criteria set out above
- In the current economic climate the Council has run down its cash balances as an alternative to borrowing and investments have been made short term and the Council would not consider using investments that fall under the ‘Non-Specified’ Investments category at this time
- If the Council decide to use these investments then Indicator 11 will need to be revised

Investment Type	Maximum Maturity Period	Minimum Credit Criteria	Collective Limit £m	Individual Limit £m
Term deposits with UK Government & Local Authorities	1-5 years	Sovereign risk high security not credit rated	20	20
Term deposits & Certificates of Deposit with Banks Group 1	1-5 years (tradable)	F1(Fitch - short term) AAA (long term)	10	10
UK Government & Local Authority Stock Issues	1-10 years (tradable)	Sovereign risk high security not credit rated	10	10
Term deposits & Certificates of Deposit with Banks Group 2	1-5 years (tradable)	F1 (Fitch-short term) A (long term)	20	10
Deposit accounts with regulated UK building societies	1 – 5 years	F1 (Fitch short term) A (long term)	5	5
Term deposits UK building societies no formal credit rating	Up to 1 year	Financial position assessed by Interim Corporate Director: Resources	5	5
Bonds issued by financial institution guaranteed by UK Govt	1-10 years (tradable)	UK Govt backed AAA (Fitch, S&P etc.)	5	5

In the current economic climate the Council has run down its cash balances as an alternative to borrowing and investments have been made short term and the Council would not consider using investments that fall under the ‘Non-Specified’ Investments category at this time.

Explanation of credit ratings		
Agency	**Short Term**	**Long Term**
Fitch	F1-Highest short-term credit quality. Indicates the strongest intrinsic capacity for timely payment of financial commitments; a “+” may be added to denote any exceptionally strong credit feature.	A-High credit quality. ‘A’ ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
Moody’s	P-1-superior ability to repay short-term debt obligations	Aa-high quality and are subject to very low credit risk
Standard & Poor’s	A-1-The obligor’s capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor’s capacity to meet its financial commitment on these obligations is extremely strong.	A-more susceptible to the adverse effects of changes in circumstances and economic conditions. However the obligor’s capacity to meet its financial commitment on the obligation is still strong.

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