

## **SLOUGH BOROUGH COUNCIL**

### **FOR INFORMATION**

#### **COPY OF REPORT CONSIDERED AND AGREED AT BUDGET COUNCIL MEETING - 25 FEBRUARY 2016**

#### **TREASURY MANAGEMENT STRATEGY 2016/17**

##### **1 Introduction & Background**

The Council is required to adopt the CIPFA Treasury Management in the Public Services: Code of Practice and it is a requirement under that Code of Practice to produce an annual strategy report on proposed treasury management activities for the year.

In accordance with the Treasury Management code, the council defines treasury management activities as:

“The management of the council’s cash flows, its banking, money market and capital market transactions; the effective control of the risks `The purpose of the Treasury Strategy is to establish the framework for the effective and efficient management of the Council’s treasury management activity, within legislative, regulatory, and best practice regimes, and balancing risk against reward in the best interests of stewardship of the public purse.

##### **2 Key Principles**

The key principles of the CIPFA Treasury Management in the Public Services: Code of Practice is that:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

In setting the Treasury Management Strategy, the Council must have regard for the following factors:

- The current treasury position and debt portfolio position
- The prospects for interest rates
- The approved Capital Programme
- Limits on treasury management activities and prudential indicators

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

According to the Prudential Code- the professional code of practice to support local authorities in taking capital investment decisions- the Council's prime policy objective of its investment activities is the security and liquidity of funds. Therefore the council should avoid exposing public funds to unnecessary or un-quantified risk. The council should consider the return on their investments; however, this should not be at the expense of security and liquidity. It is therefore important that the council adopt an appropriate approach to risk management with regard to its investment activities. The council employs a Treasury Management advisor, Arlingclose, to assist in the management of risk.

### **3 Current Economic Climate**

Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 81st consecutive month at its meeting in November 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.

The outcome of the UK general election, which was largely fought over the parties' approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course. The Federal Reserve did not raise policy rates at its meetings in October and November, but the statements accompanying the policy decisions point have made a rate hike in December

2015 a real possibility. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

**Credit outlook:** The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The Bank Recovery and Resolution Directive promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast Deposit Guarantee Schemes Directive includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, the credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Authority.

**Interest rate forecast:** The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

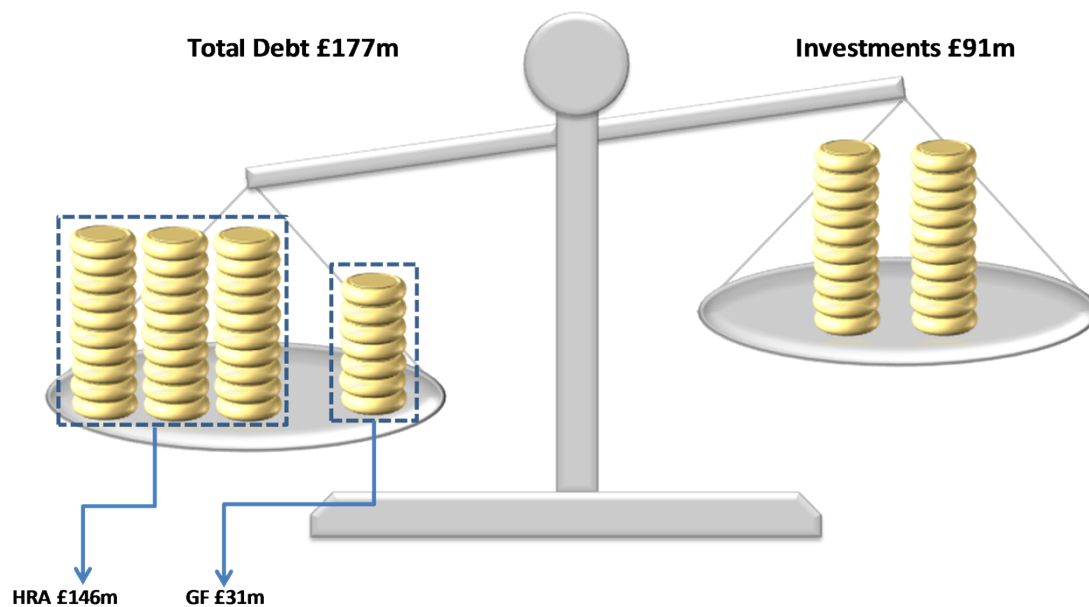
A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and US interest rate rises are likely to prompt short-term volatility in gilt yields.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.20%.

#### **4 Current Position**

The Authority currently has £177.4m of borrowing and £91.2m of investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.



**Table 1: Balance Sheet Forecast**

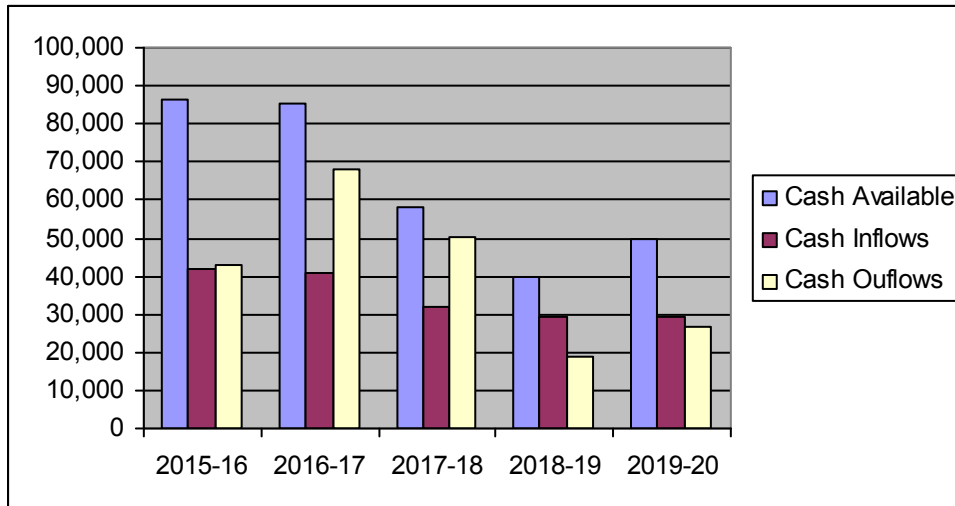
<b>Slough Borough Council</b>						
<b>Balance Sheet Summary and Projections in £millions</b>						
	<b>31<sup>st</sup> March</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
General Fund Capital Financing Requirement		136.9	142.90	159.00	174.60	177.20
HRA Capital Financing Requirement		158.1	158.1	158.1	158.1	158.1
<b>Total Capital Financing Requirement</b>		<b>295.0</b>	<b>301.0</b>	<b>317.10</b>	<b>332.70</b>	<b>335.30</b>
Less: Other long-term liabilities *		(49.60)	(46.4)	(44.3)	(42.5)	(40.4)
<b>Loans Capital Financing Requirement</b>		<b>245.40</b>	<b>254.60</b>	<b>272.80</b>	<b>290.20</b>	<b>294.90</b>
Less: External borrowing **		(182.3)	(177.3)	(173.30)	(189.4)	(205.0)
<b>Internal (over) borrowing</b>		<b>63.10</b>	<b>77.3</b>	<b>99.50</b>	<b>100.80</b>	<b>89.90</b>
Less: Usable reserves		(120.1)	(116.1)	(114.0)	(113.0)	(113.0)
<b>Net Borrowing Requirement/(Investments)</b>		<b>(57.00)</b>	<b>(38.80)</b>	<b>(14.50)</b>	<b>(12.20)</b>	<b>(23.10)</b>

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

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

**Table 1a: Cash Flow Forecast**

	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>
<b>Cash Available</b>	86,342	85,254	58,199	39,780	49,889
<b>Cash Inflows</b>	41,937	40,847	32,046	29,102	29,158
<b>Cash Outflows</b>	43,025	67,903	50,465	18,993	26,703



The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves are the underlying resources available for investment. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2016/17.

## 5 **Borrowing Strategy**

The Authority currently holds £177.3 million of loans, an decrease of £5m million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow] in 2016/17.

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

**Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. 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 rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2016/17 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

**Sources:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable 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

The Authority has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

**LGA Bond Agency:** Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for 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 and the Capital Strategy Board.

**LOBOs:** The Authority holds £13m 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. £4m of these LOBOS have options during 2016/17, 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. Total borrowing via LOBO loans will be limited to the current £13m.

**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 below.

**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.

**Table 2: Current Borrowing Position**

PWLB or Market	Type	Loan	Start Date	Maturity	Principal	Type
PWLB	Fixed	497998	30/09/2010	30/03/2017	4,000,000	Pooled
PWLB	Fixed	497752	27/08/2010	24/08/2017	3,000,000	Pooled
PWLB	Fixed	497999	30/09/2010	29/09/2021	4,000,000	Pooled
PWLB	Fixed	498000	30/09/2010	29/09/2024	4,000,000	Pooled
PWLB	Fixed	498001	30/09/2010	30/09/2027	4,000,000	Pooled
PWLB	Fixed	487800	28/05/2003	25/03/2028	1,000,000	Pooled
PWLB	Fixed	500578	28/03/2012	28/03/2028	20,000,000	HRA Self Financing
PWLB	Fixed	488859	08/07/2004	25/09/2029	500,000	Pooled
PWLB	Fixed	481989	14/01/1999	25/03/2030	31,126	Pooled
PWLB	Fixed	489227	28/10/2004	15/10/2031	5,000,000	Pooled
PWLB	Fixed	500582	28/03/2012	28/03/2032	20,000,000	HRA Self Financing
PWLB	Fixed	490923	22/12/2005	01/05/2036	3,000,000	Pooled
PWLB	Fixed	490924	22/12/2005	01/08/2036	5,000,000	Pooled
PWLB	Fixed	500579	28/03/2012	28/03/2037	20,000,000	HRA Self Financing
PWLB	Fixed	494837	01/10/2008	01/08/2038	5,000,000	Pooled
PWLB	Fixed	500584	28/03/2012	28/03/2039	20,000,000	HRA Self Financing
PWLB	Fixed	500581	28/03/2012	28/03/2041	15,841,000	HRA Self Financing
PWLB	Fixed	500580	28/03/2012	28/03/2042	20,000,000	HRA Self Financing
PWLB	Variable	500583	31/03/2012	28/03/2022	10,000,000	HRA Self Financing
Market	LOBO	64	12/07/2004	12/07/2054	4,000,000	Pooled
Market	LOBO	65	07/04/2006	07/04/2066	5,000,000	Pooled
Market	LOBO	66	28/04/2006	28/04/2066	4,000,000	Pooled
					<b>177,372,126</b>	

## 6 Housing Revenue Account Self-Financing

Central Government completed its reform of the Housing Revenue Account Subsidy system at the end of 2011/12. Local authorities are required to recharge interest expenditure and income attributable to the HRA in accordance with Determinations issued by the Department for Communities and Local Government.

The Determinations do not set out a methodology for calculating the interest rate to use in each instance. The Council is therefore required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA

Code recommends that authorities present this policy in their TMSS. 3 On 1st April 2012, the Council notionally split each of its existing long-term loans into General

Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. As part of the reform of the HRA Housing Revenue Account Subsidy system at the end of 2011/12, the HRA needed to make a payment of £135.841m to the Government. £125.841m of this was financed by PWLB loans listed above. £10m was in respect of an internal loan from the General Fund. The General Fund currently charges 3.27% interest on this amount or £327,000 per annum.

## 7 **Investment Strategy**

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £81 and £107 million, and similar levels are expected to be maintained in the forthcoming year.

**Objectives:** Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

**Strategy:** Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2016/17 where opportunities arise. This is especially the case for the estimated £40m that is available for longer-term investment. The authority has reduced the amount it invests in short-term unsecured bank deposits, certificates of deposit and money market funds to around 45% of its total investments. Most of these investments are for the management of the authority's short term cash flow, and are invested in either instant access call accounts or notice accounts where the exposure is for a maximum of 95days.

**Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved Investment Counterparties and Limits

<b>Credit Rating</b>	<b>Banks Unsecured</b>	<b>Banks Secured</b>	<b>Government</b>	<b>Corporates</b>	<b>Registered Providers</b>
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£15m 5 years	£15m 20 years	£15m 50 years	£5m 20 years	£5m 20 years
AA+	£15m 5 years	£15m 10 years	£15m 25 years	£5m 10 years	£5m 10 years
AA	£15m 4 years	£15m 5 years	£15m 15 years	£5m 5 years	£5m 10 years
AA-	£15m	£15m	£15m	£5m	£5m



	3 years	4 years	10 years	4 years	10 years
A+	£15m 2 years	£15m 3 years	£15m 5 years	£5m 3 years	£5m 5 years
A	£15m 13 months	£15m 2 years	£15m 5 years	£5m 2 years	£5m 5 years
A-	£15m 6 months	£15m 13 months	£15m 5 years	£5m 13 months	£5m 5 years
BBB+	£5m 100 days	£5m 6 months	£15m 2 years	£2.5m 6 months	£2.5m 2 years
BBB or BBB-	£5m next day only	£15m 100 days	n/a	n/a	n/a
None	£3m 12 months	n/a	£5m 25 years	n/a	£5m 5 years
Pooled funds	£10m per fund				

This table must be read in conjunction with the notes below

† The time limit is doubled for investments that are secured on the borrower's assets

\* But no longer than 2 years in fixed-term deposits and other illiquid instruments

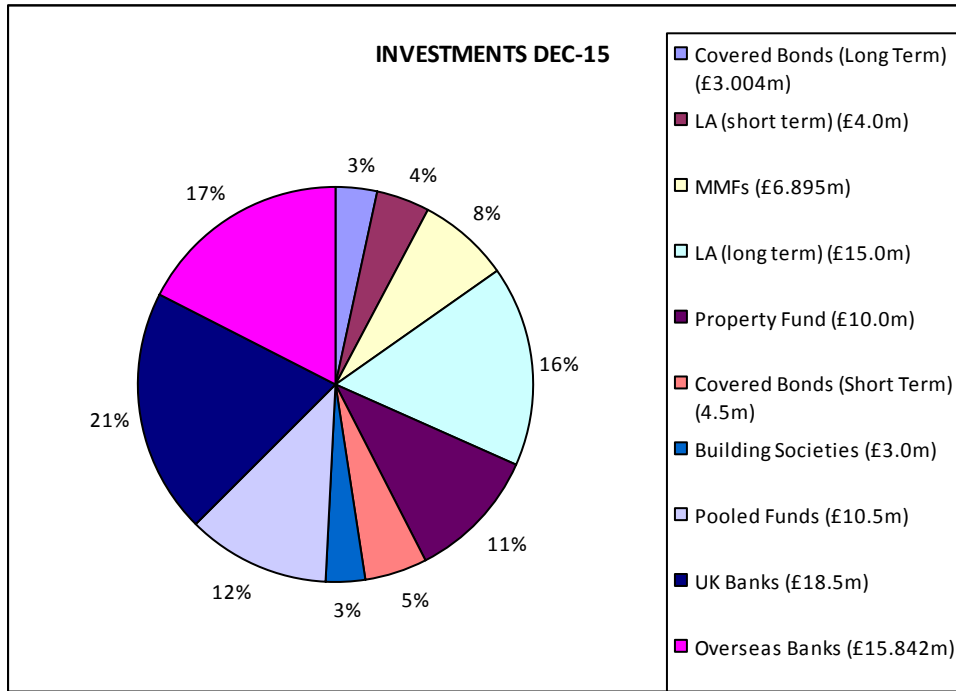
\*\* But no longer than 5 years in fixed-term deposits and other illiquid instruments

There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented.

In addition, the Authority may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Authority's treasury management adviser.

The current level of investments and the type of institution invested in is summarised below:

Table 4: Current Investments



£17.737m of the above is in instant access accounts (i.e. Call Accounts and Money Market Funds) and £8.5m in 95 day notice accounts.

## 8 Investment Opportunities

**Credit Rating:** Investment decisions are made 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.

**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.

**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 paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made 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 Homes and Communities Agency and, as providers of public services, they retain a high 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. Money Market Funds that offer same-day liquidity and aim for a constant net asset value 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.

**Slough Urban Regeneration:** The Authority has entered into a partnership with Morgan Sindall, a Private Sector developer, for the regeneration of Slough. Under this partnership, Authority's land assets are transferred into the SUR vehicle. The Authority then receives a loan note from the SUR for the value of the land transferred. This loan note is then repaid by the SUR over time and the Authority will receive interest on the loan note of 6%.

## 9 **Risk Management**

**Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks,

which indicate a long-term direction of travel rather than an imminent change of rating.

**Other Information on the Security of Investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

**Specified Investments:** The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

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

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

Table 3: Non-Specified Investment Limits

	<b>Cash limit</b>
Total long-term investments	£40m
Total investments without credit ratings or rated below A-	£10m
Total investments with institutions domiciled in foreign countries rated below AA+	£10m
Total non-specified investments	£60m

## 10 **Investment Limits**

The Authority's revenue reserves available to cover investment losses are forecast to be £84 million on 31st March 2016. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below:

Table 4: Investment Limits

	<b>Cash limit</b>
Any single organisation, except the UK Central Government	£15m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£15m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker's nominee account	£25m per broker
Foreign countries	£10m per country
Registered Providers	£5m in total
Unsecured investments with Building Societies	£10m in total
Loans to unrated corporates	£5m in total
Money Market Funds	£50m in total
Slough Urban Renewal Loan Notes	£5m above land value

## 11 **Prudential Indicators**

The Local Government Act 2003 required the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

A key indicator of prudence is to ensure that over the medium term net borrowing will only be for a capital purpose and that net external borrowing does not except in the short term, exceed the total capital financing requirement in the preceding year plus

the estimates of any additional capital financing requirements for the current and the next two financial years.

**Estimates of Capital Expenditure:** The Authority's planned capital expenditure and financing may be summarised as follows.

**Table 5: Capital Programme**

<b>Capital Expenditure and Financing</b>	<b>2015/16 Revised £m</b>	<b>2016/17 estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
General Fund	49,780	76,962	39,007	15,669
HRA	19,837	15,092	14,144	14,244
<b>Total Expenditure</b>	<b>69,617</b>	<b>92,054</b>	<b>53,151</b>	<b>29,913</b>
Capital Receipts	-1,400	-2,130	-2,430	-1,500
Grants & Contributions	-23,669	-45,592	-20,634	-11,049
Revenue	-9,637	-7,392	-6,144	-6,244
Reserves	-9,000	-6,500	-6,500	-6,500
Borrowing (incl. internal)	-25,911	-30,440	-17,443	-4,620
<b>Total Financing</b>	<b>-69,617</b>	<b>-92,054</b>	<b>-53,151</b>	<b>-29,913</b>

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

<b>Capital Financing Requirement</b>	<b>31.03.16 Revised £m</b>	<b>31.03.16 Estimate £m</b>	<b>31.03.17 Estimate £m</b>	<b>31.03.18 Estimate £m</b>
General Fund	144	149.3	154.1	156.1
HRA	158.1	158.1	158.1	158.1
<b>Total CFR</b>	<b>302.1</b>	<b>307.4</b>	<b>312.2</b>	<b>314.2</b>

The CFR is forecast to rise by £15m over the next two years as capital expenditure financed by internal borrowing outweighs resources put aside for debt repayment before reducing in subsequent years where budgeted capital expenditure reduces.

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

<b>Debt</b>	<b>31.03.16 Estimate £m</b>	<b>31.03.17 Estimate £m</b>	<b>31.03.18 Estimate £m</b>	<b>31.03.19 Estimate £m</b>
Borrowing	177.372	173.372	170.372	170.372
Finance leases	9.853	8.533	7.443	6.496
PFI liabilities	36.545	35.816	35.087	33.905
<b>Total Debt</b>	<b>223.770</b>	<b>217.721</b>	<b>212.902</b>	<b>210.773</b>

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

**Operational Boundary for External Debt:** The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

<b>Operational Boundary</b>	<b>2015/16 Revised £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
Borrowing	258.602	260.651	282.470	284.599
Other long-term liabilities	46.398	44.349	42.530	40.401
<b>Total Debt</b>	<b>305.000</b>	<b>305.000</b>	<b>325.000</b>	<b>325.000</b>

**Authorised Limit for External Debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

<b>Authorised Limit</b>	<b>2015/16 Revised £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
Borrowing	268.602	270.651	292.47	295.599
Other long-term liabilities	46.398	44.349	42.53	40.401
<b>Total Debt</b>	<b>315.000</b>	<b>315.000</b>	<b>335.000</b>	<b>336.000</b>

**Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital

expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2015/16 Revised %</b>	<b>2016/17 Estimate %</b>	<b>2017/18 Estimate %</b>	<b>2018/19 Estimate %</b>
General Fund	7.75	7.19	7.25	7.93
HRA	12.53	12.56	12.35	12.31

**Incremental Impact of Capital Investment Decisions:** This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme

<b>Incremental Impact of Capital Investment Decisions</b>	<b>2016/17 Estimate £</b>	<b>2017/18 Estimate £</b>	<b>2018/19 Estimate £</b>
General Fund - increase in annual band D Council Tax	11.79	6.69	1.41
HRA - increase in average weekly rents	11.27	11.27	11.27

## 12 MRP Statement 2016/17

CLG's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

MRP in 2015/16: Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) Non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses). There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

The MRP Statement will be submitted to Council before the start of the 2016/17 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

The Authority will apply Option 1/Option 2 in respect of supported capital expenditure funded from borrowing and Option 3/Option 4 in respect of unsupported capital expenditure funded from borrowing and Private Finance Initiative schemes. MRP in respect of leases brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.



## 13 Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following four new prudential indicators.

- Upper limits on variable rate exposure. This indicator identifies a maximum limit for variable interest rates based upon the debt provision net of investments.
- Upper limits on fixed rate exposure. Similar to the previous indicators, this covers a maximum limit on fixed interest rates
- Total principal funds invested for a period longer than 364 days. These limits are set to reduce the need for early sale of an investment and are based on the availability of investments after each year-end
- Maturity Structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing

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 the amount of principal borrowed will be:

<b>LIMITS ON INTEREST RATE EXPOSURE</b>			
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Limit on Principal invested beyond year end	£45m	£45m	£45m
Upper limit on fixed interest rate exposure	£100m	£100m	£100m
Upper limit on variable interest rate exposure	£50m	£50m	£50m

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

### **Mature 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:

<b>MATURITY STRUCTURE OF BORROWING</b>			
	<b>Existing Level</b>	<b>Lower</b>	<b>Upper</b>
Under 12 months	8.0	0%	50%
12 months and within 24 months	3.0	0%	50%
24 months and within 5 years	4.0	0%	50%
5 years and within 10 years	8.0	0%	75%
10 years and within 15 years	30.0	25%	95%
15 years and within 20 years	25.5	25%	95%
20 years and within 25 years	53.0	25%	95%
Over 25 years	45.8	25%	95%

## 14 Other Items

There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

**Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

**Policy on Apportioning Interest to the HRA:** On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

**Investment Training:** The needs of the Authority's treasury management staff for training in investment management are assessed every three months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staffs regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staffs are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

**Investment Advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

**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.

## 15 Future Options

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer 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 below.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income. Impact of premiums.	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain.
Invest with Local Authorities for periods in excess of 12 months	Higher rates achieved initially.	Risk that interest rates will rise (interest rate risk)
Invest in Building Societies not currently on the Council's Counterparty Risk	Potential higher returns	Risk of Credit Related Defaults as most Building Societies are unrated.
Invest in Government Treasury Bills	Very Low returns	No risk of credit default.
Invest in Registered Providers/Housing Associations.	5 year loan floating at 200bps over 6-month LIBOR (currently 0.59%) with a credit rated RP (A2 with Moody's) —5 year fixed rate loan at c3.35% with an unrated RP (Unrated RPs will pledge a pool of housing assets as security for loans borrow). Downside 6 weeks set up time.	Strong regulatory framework and oversight; Conservative financial management; High likelihood of government support
Invest in pooled Property Funds	Potentially higher returns though will require more monitoring and returns could fluctuate greatly.	Risks of investing in a property fund – very similar to the risks of direct purchases —Void periods will result in lower returns —Falling property values

		<p>can result in capital losses</p> <p>—Entry and exit costs – either as subscription/redemption fees or a bid-offer spread</p> <p>—Low liquidity compared to other types of pooled funds – 6 months’ notice is common</p> <p>Our TMA therefore recommend a minimum investment horizon of at least 5 years</p>
Pooled Funds-Liquidity Plus	Next step up from Money Market Funds. Almost as liquid as MMFs but with potentially higher returns.	As secure as MMFs we currently use but with greater fluctuations in yield.
Other Pooled Funds- e.g. Corporate Bonds, Equities.	<p>Pooled funds provide opportunities for income as well as capital appreciation.</p> <p>Accounting rules typically mean that capital gains and losses are not taken to revenue until units are sold</p>	Due to the potential volatility, the Council should be prepared for the possibility of capital value to fall before it rises
Upfront Payment of Employer Contributions to the Pension Fund	The council will save over 3% in employer contributions if it makes an upfront payment of approx £10m to the Pension Fund.	No risk other than the estimate must be robust and cannot under estimate the amount of contributions payable in the year.
Loan Notes issued through SUR.		

## 16 **Ethical Investment Policy**

The preservation of capital is the Council’s principal and overriding priority. The banks and building societies on the Council’s lending list are selected only if the institutions and the sovereign meet minimum credit criteria. In accordance with its social and corporate governance responsibilities, the Council seeks to support institutions which additionally have an ethical and responsible approach to environmental and social issues including employment and global trade

The Council could seek to invest in specific ethical funds, though there would be a charge to undertake the risk analysis of doing so from the Council’s Treasury Management advisors

## **Appendix A – Arlingclose Economic & Interest Rate Forecast November 2015**

### **Underlying assumptions:**

- UK economic growth softened in Q3 2015 but remained reasonably robust; the first estimate for the quarter was 0.5% and year-on-year growth fell slightly to 2.3%. Negative construction output growth offset fairly strong services output, however survey estimates suggest upwards revisions to construction may be in the pipeline.
- Household spending has been the main driver of GDP growth through 2014 and 2015 and remains key to growth. Consumption will continue to be supported by real wage and disposable income growth.
- Annual average earnings growth was 3.0% (including bonuses) in the three months to August. Given low inflation, real earnings and income growth continue to run at relatively strong levels and could feed directly into unit labour costs and households' disposable income. Improving productivity growth should support pay growth in the medium term. The development of wage growth is one of the factors being closely monitored by the MPC.
- Business investment indicators continue to signal strong growth. However the outlook for business investment may be tempered by the looming EU referendum, increasing uncertainties surrounding global growth and recent financial market shocks.
- Inflation is currently very low and, with a further fall in commodity prices, will likely remain so over the next 12 months. The CPI rate is likely to rise towards the end of 2016.
- China's growth has slowed and its economy is performing below expectations, which in turn will dampen activity in countries with which it has close economic ties; its slowdown and emerging market weakness will reduce demand for commodities. Other possible currency interventions following China's recent devaluation will keep sterling strong against many global currencies and depress imported inflation.
- Strong US labour market data and other economic indicators suggest recent global turbulence has not knocked the American recovery off course. Although the timing of the first rise in official interest rates remains uncertain, a rate rise by the Federal Reserve seems significantly more likely in December given recent data and rhetoric by committee members.
- Longer term rates will be tempered by international uncertainties and weaker global inflation pressure.

## Forecast:

- Arlingclose forecasts the first rise in UK Bank Rate in Q3 2016. Further weakness in inflation, and the MPC's expectations for its path, suggest policy tightening will be pushed back into the second half of the year. Risks remain weighted to the downside. Arlingclose projects a slow rise in Bank Rate, the appropriate level of which will be lower than the previous norm and will be between 2 and 3%.
- The projection is for a shallow upward path for medium term gilt yields, with continuing concerns about the Eurozone, emerging markets and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and global growth weakness, are likely to prompt short term volatility in gilt yields.

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
<b>Official Bank Rate</b>													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
<b>3-month LIBID rate</b>													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.55	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.85
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
<b>1-yr LIBID rate</b>													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
<b>5-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
<b>10-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
<b>20-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
<b>50-yr gilt yield</b>													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15