Treasury Management and Investment Strategy 2017/18 & Prudential Indicators

Report by Gary Fairley, Head of Finance and Integrated Service Support

1 Purpose of Report

The purpose of the report is to seek the agreement of Council to the Treasury Management and Annual Investment Strategies for 2017/18 and the Prudential and Treasury indicators contained therein.

2 Treasury Management & Investment Strategy 2017/18

2.1 Current Loan and Investment Portfolio

The Council's current loan and investment portfolio, as at 27 January 2017, is shown in tables 1 and 2 below:-

Table 1: Current Loan Portfolio as at 27 January 2017

Loan Type	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	739	8.90%
PWLB Maturity	197,224	3.77%
LOBO	20,000	4.51%
Temporary Market Loans	36,000	0.25%
Other Loans	357	0.00%
Total Loans	**254,320**	**3.34%**

Table 2: Current Investment Portfolio as at 27 January 2017

Investment Type	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	0	n/a
Money Market Funds	17,941	0.30%
Bank Notice Accounts	64,985	0.85%
Total Investments	**82,926**	**0.73%**

2.2 Borrowing Requirement 2016/17 to 2021/22

The Council's capital plans contain projections of capital expenditure and income over the forthcoming financial years. Any expenditure not financed directly by income, requires funding through borrowing.

The projected borrowing requirement arising from the Council's Capital Plans, and the maturing long-term loans that require to be refinanced, over the period 2016/17 to 2021/22 is shown in table 3 below:-

Table 3: Total Borrowing Requirement over the period 2016/17 to 2021/22

	2016/17 £000's	2017/18 £000's	2018/19 £000's	2019/20 £000's	2020/21 £000's	2021/22 £000's	Total £000's
Capital Expenditure							
General Services	34,702	24,263	22,744	19,849	20,576	11,495	**133,629**
HRA	18,393	41,945	27,095	19,434	6,711	5,758	**119,336**
Total Capital Expenditure	**53,095**	**66,208**	**49,839**	**39,283**	**27,287**	**17,253**	**252,965**
Total Available Financing	-23,851	-15,608	-16,513	-17,765	-12,923	-9,960	**-96,620**
Principal Debt Repayments	-7,293	-7,927	-8,883	-9,531	-10,299	-10,863	**-54,796**
Capital Expenditure less available Financing	**21,951**	**42,673**	**24,443**	**11,987**	**4,065**	**-3,570**	**101,549**
Maturing Loans	2,090	10,271	10,452	9,131	9,142	1,394	**42,480**
Total Borrowing Requirement	**24,041**	**52,944**	**34,895**	**21,118**	**13,207**	**-2,176**	**144,029**
Borrowing secured	-20,000	-10,000	-10,000	0	0	0	-40,000
Total Remaining Borrowing Requirement	**4,041**	**42,944**	**24,895**	**21,118**	**13,207**	**-2,176**	**104,029**

2.3 Borrowing Strategy for remainder of 2016/17 and 2017/18

Long-term borrowing rates from the Debt Management Office's (DMO) Public Works Loans Board (PWLB) are currently sitting at, or close to, historical lows. Whilst the Council has already secured the majority of its borrowing requirement for financial year 2016/17, as can been noted from Table 3 above the Council has a significant borrowing requirement across the forthcoming 2 financial years (2017/18 and 2018/19).

Part of this borrowing requirement has already been secured through two forward dealt loans. This involved the Council committing to draw down two £10 million loans at fixed interest rates that were priced against historically low borrowing rates, with minimal cost of carry and allowed the Council to hedge against future borrowing rate movements, thereby representing an extremely viable alternative to traditional PWLB borrowing and adding certainty to the Council's loan portfolio. The first of these two loans is to be drawn on 29 June 2017 and the second on 15 November 2018, with these dates matched to two £10 million PWLB loans maturing on the same dates.

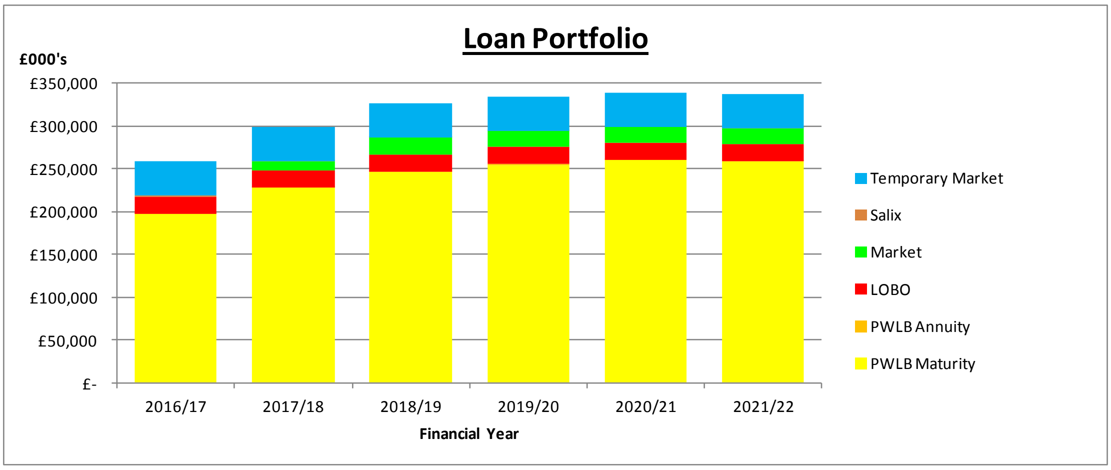
It is expected that the majority of the remaining borrowing requirement to fund capital expenditure incurred in 2017/18 and 2018/19 shall be sourced from PWLB. However, the opportunity continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans throughout the remainder of 2016/17 and into 2017/18.

In addition to the longer-term element of the borrowing portfolio as noted above, the current low Bank of England base rate level of 0.25% and the expectation that base rate will not rise markedly in the short-medium term, means that continued utilisation of an element of temporary borrowing within the Council's overall loan portfolio (current level of £36.0 million as at 27 January 2017 at an average borrowing rate of 0.25% as shown in Table 1) would continue to provide a cost-effective solution to the Council. The quantum of this will continue to be assessed against the backdrop of potential long term costs if the opportunity is missed to take PWLB loans at historically low medium-long term rates, particularly given the projected gradual rise in PWLB rates.

Officers will ensure that any loans taken are drawn to match the existing maturity and projected capital expenditure profiles as closely as possible, that proposed interest rates continue to sit below forward interest rate projections, and that the overall borrowing remains within the Authorised Limit of £384.042 million proposed below.

Any other borrowing undertaken in advance of need would be supported by a business case which will appraise the anticipated savings in borrowing costs (from expected increases in rates later in the year / in forthcoming years) against the carrying cost associated with borrowing in advance of need.

The Council's projected loan portfolio over the period 2016/17 to 2021/22 is shown in graphical format below.



2.3 Investment Strategy

The investment environment remains challenging, with the continued scrutiny over the creditworthiness of counterparties resulting in an ever tighter counterparty list. At the same time, the low 0.25% Bank of England base rate dictates low returns of typically sub 1% for a 12 month fixed term deposit.

The position on potential investment opportunities remains broadly as reported to Council in the Treasury Management Mid-Year Update report on 08 November 2016.

£40.000 million of the Council's investments are held in fixed term deposits which mature in late March / early April 2017 and £24.985 million in bank notice accounts (with the notice period equating to broadly 6 months). Council officers, in conjunction with Capita Asset

Services will continue to review the range of investment options available to the Council, within the proposed Permitted Investments included as Appendix 1, in order to select only the most creditworthy counterparties to ensure the security of Council funds, and from that list select the range of investment products that offer best value to the Council's investment portfolio.

3 Prudential Indicators

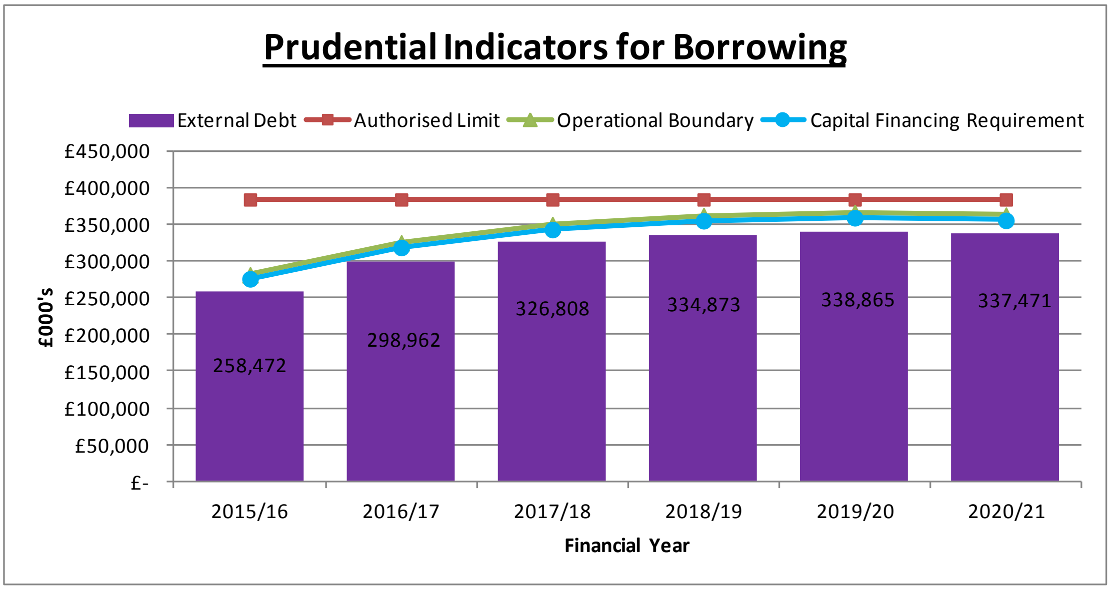
Prudential Code for Capital Finance in Local Authorities

The Prudential Code for Capital Finance in Local Authorities requires that Councils can demonstrate that their Capital Plans are affordable, prudent and sustainable, taking into account the financial provisions made in current and future revenue budgets; and that Treasury Management decisions are taken in accordance with good practice.

The Prudential Indicators that Councils need to consider relate to both actual, historic outcomes, and future estimated outcomes (covering the same period as the Council's Capital Plans), as follows:-

- Original indicators and actual outcomes for 2015/16;
- Revised estimates of the 2016/17 indicators; and
- Estimates of indicators for 2017/18 to 2021/22.

The Prudential Indicators required by the Code are listed individually in Appendix 2. The key indicators relating to external borrowing are shown in graphical format below.



The **Capital Financing Requirement (CFR)** denotes the Council's underlying need to borrow for capital purposes. The CFR includes borrowing arising as a result of the Council's Capital Plans, plus the long-term liability arising from the Council's two PPP contracts. The Underlying Borrowing Requirement strips out the latter of these (long-term liability arising from the two PPP contracts) from the CFR.

The **Authorised Limit for Borrowing** represents the limit beyond which borrowing is prohibited, and needs to be set and revised by

Members. It is the expected maximum borrowing need with some headroom for unexpected movements.

The Authorised Limit for Borrowing has been calculated by taking the maximum value of the CFR over the next 5 financial years (2017/18 to 2021/22), with the total forecast level of capital receipts and developer contributions added back to this figure (given the inherent uncertainty regarding the timing and value of these receipts/contributions). This is shown in table 4 below.

Table 4: Authorised Limit for Borrowing: Calculation

Authorised Limit	**Amount £000's**
CFR – General Services (31 March 2021)	128,063
CFR – HRA (31 March 2021)	231,089
Unrealised Capital Receipts & Developer Contributions 2016/17	10,105
Forecast level of Capital Receipts & Developer Contributions 2017/18 to 2021/22	14,785
Proposed Authorised Limit	**384,042**

Council is therefore asked to approve an adjustment to the authorised limit for borrowing to £384.042million, if market conditions support this action. This would have the effect of securing lower costs for future years but care would be taken to ensure that the cost of carry from borrowing early is minimized and that the maturity structure of all debt is sufficiently robust to ensure that the CFR at 31 March 2022 remains achievable.

The authorised limit therefore reflects a level of borrowing which, while not desired, could be afforded but is not sustainable.

Statutory repayment of loans fund advances

Under Finance Circular 7/2016, Council is now required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

- For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply what is termed "the Statutory Method", with all loans fund advances being repaid by the annuity method.
- For loans fund advances made after 1 April 2016, the policy for the repayment of loans advances is proposed to continue to operate under the "Statutory Method" – i.e. loans fund

advances will be repaid by the annuity method. This annuity rate that is proposed to be applied to the loans fund repayments is based on historic interest rates and is currently 3.20%.

Under current legislation, the Statutory Method i.e. the annuity approach can be applied up to and including 31 March 2021, at which point consideration will need to be given to a number of alternative methods, with the broad aim to ensure that repayment periods are ‘reasonably commensurate with the period and pattern of the benefits provided to the community from capital expenditure’. Officers will review the impact of this on loan charges from 31 March 2021 and report back to Council in due course.

4. Report Implications

4.1 Resources

There are no direct resource implications arising from this report.

4.2 Risk

The strategies outlined in this report are designed to improve the overall risk management of Treasury activity. Providing the limits outlined in the strategies are observed they will enhance the controls already in place in the Treasury Management Practices within which the treasury function operates.

The Prudential Indicators contained in Appendix 2 improve the overall risk management of Capital Investment and Treasury Management.

4.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- ☐ Community safety
- ☐ Adult health, care and housing
- ☐ Getting it right for every Midlothian child
- ☐ Improving opportunities in Midlothian
- ☐ Sustainable growth
- ☐ Business transformation and Best Value
- ☒ None of the above

4.4 Impact on Performance and Outcomes

The strategies to be adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council’s capital expenditure is sustainable in revenue terms.

4.5 Adopting a Preventative Approach

The proposals in this report do not directly impact on the adoption of a preventative approach.

4.6 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Capita Asset Services, the Council's appointed Treasury Consultants.

4.7 Ensuring Equalities

There are no equality issues arising from this report.

4.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

4.9 Digital Issues

There are no IT issues arising from this report.

5 Summary

The Treasury Management and Investment Strategies outlined in this document, and in the detailed document that has been placed in the Member's Library / uploaded to the Council's Committee Management System, have been formulated to comply with the revised Codes of Practice and relevant Regulations and provide the framework for achieving best value in the management of the Council's borrowing and investment portfolios.

6 Recommendations

It is recommended that the Council

a) Approve the Treasury Management and Investment Strategy for the 2017/18 financial year, as detailed in Section 2 of this report;
b) Approve the list of Permitted Investments outlined in Appendix 1;
c) Adopt the Prudential Indicators contained in Appendix 2 of this report;
d) Approve an adjustment to the Authorised Limit for Borrowing to £384.042 million (as shown in Section 3) if market conditions indicate that this is prudent;
e) Note that the policy to repay loans fund advances made before 1 April 2016 will be to continue to use the 'Statutory annuity method';
f) Approve the policy for the statutory repayment of loans fund advances made from 1 April 2016 to be the 'Statutory annuity method' and that the current annuity rate applied is 3.20%.

Date:- 31 January 2017

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Background Papers:-
Appendix 1:- Permitted Investments
Appendix 2:- Prudential Indicators
Appendix 3:- Treasury Management & Annual Investment Strategy Statement – 2017/18 Detailed – placed in Member's Lounge / uploaded to Committee Management System

Permitted Investments Appendix 1

The Council uses the Capita creditworthiness service. This utilises credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard & Poors, along with credit watches, outlooks, CDS spreads and country sovereign ratings in a weighted scoring system with an end product of a series of colour coded bands which indicate the relative creditworthiness of counterparties for investment.

These colour codes are used by the Council to determine the maximum suggested duration for investment with that counterparty. These are as follows:-

Capita Colour Code	**Maximum Suggested Duration for Investment**
Yellow	6 years*
Dark Pink	6 years**
Light Pink	6 years**
Purple	3 years
Blue	2 years***
Orange	2 years
Red	8 months
Green	120 days
No colour	Not to be used

* *Note the yellow colour category is for:- UK Government Debt, or its equivalent, constant NAV Money Market Funds (MMF's), and collateralised deposits where the collateral is UK Government Debt*

** *Dark Pink for Enhanced MMF's with a credit score of 1.25; Light Pink for Enhanced MMF's with a credit score of 1.5*

*** *Only applies to nationalised or semi-nationalised UK banks*

**** *The Green Limit was formerly for 3 months but the Financial Conduct Authority set (in July 2013) a requirement for qualifying deposits for bank liquidity buffers of a minimum of 95 days so the Green Limit has been slightly extended to accommodate this regulatory change*

Note that the maximum suggested durations listed above have been extended by 1 year (when compared to the suggested maximum durations provided by Capita) for the Yellow, Dark Pink, Light Pink, Purple, Blue and Orange categories, to allow flexibility around these durations on the margins e.g. the placement of a 13 month fixed term deposit for a counterparty rated Orange or Blue. Equally, the maximum suggested duration for the Red category has been extended by a month to 8 months, and the maximum duration for the Green category has been extended by 20 days to 120 days, on the same basis. A thorough appraisal of the additional risk involved in extending the duration of any deposit (marginally) beyond the maximum suggested by Capita, against any enhanced value to the portfolio, will be undertaken prior to the placement of any deposit.

1.1 Deposits

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Debt Management Agency Deposit Facility	--	Term	No	**100%**	**6 months**
Term deposits – local authorities	--	Term	No	**100%**	**2 years**
Call accounts – banks and building societies	Green	Instant	No	**100%**	**1 day**
Term deposits / Notice Accounts – banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**

1.2 Deposits with counterparties currently in receipt of government support / ownership

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
UK nationalised banks – Call accounts	Blue	Instant	No	**100%**	**1 day**
UK nationalised banks – Term Deposits / Notice Accounts	Blue	Term	No	**100%**	**2 years**
UK nationalised banks – Fixed term deposits with variable rate and variable maturities: - Structured deposits	Blue	Term	No	**100%**	**2 years**
Non-UK(high sovereign rated country) nationalised banks – Call accounts	Green	Instant	No	**100%**	**1 day**
Non-UK (high sovereign rated country) nationalised banks:- Term Deposits / Notice Accounts	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**
Non-UK (high sovereign rated country) nationalised banks:- Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**

If forward deposits are made, the forward period plus the deal period equate to the maximum maturity period.

1.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Government Liquidity Funds	AAA	Instant	No	**100%**	**1 day**
Money Market Funds	AAA	Instant	No	**100%**	**1 day**
Enhanced Money Market / Cash Funds with a credit score of 1.25	AAA	T+1 to T+5	Yes	**100%**	**1 day**
Enhanced Money Market / Cash Funds with a credit score of 1.5	AAA	T+1 to T+5	Yes	**100%**	**1 week**
Bond Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**
Gilt Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**

1.4 Securities issued or guaranteed by governments

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max %?£m of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
UK Government Gilts	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	Yes	**100%**	**50 years**
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	Sale T+1	Yes	**10)%**	**50 years**

1.5 Securities issued by corporate organisations

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Sale T+1	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 7 mths Up to 100 days Not for use**
Commercial paper other	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 7 mths Up to 100 days Not for use**
Floating rate notes	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 7 mths Up to 100 days Not for use**
Corporate Bonds other	Yellow Purple Blue Orange Red Green No Colour	Sale T+3	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 7 mths Up to 100 days Not for use**

1.6 Other

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Local authority mortgage guarantee scheme.	Blue	Term	No	**50%**	**5 years**
Loans to Third Parties	n/a	Term	No	**£25m**	**20 years**
Subordinated Debt Subscription to Newbattle Centre SPV	n/a	Term	No	**£1m**	**27 years**
Property Funds	n/a	T+4	Yes	**50%**	**15 years**

Prudential Indicators Appendix 2

1. Prudential Indicators for Affordability

1.1 Estimates of Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream								
%	2015/16	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Original	Actual	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
General Services	**3.86%**	**3.69%**	3.57%	3.86%	3.86%	3.71%	3.70%	3.74%
HRA	**36.37%**	**35.00%**	34.35%	35.40%	38.16%	39.00%	41.57%	42.23%

1.2 Estimates of the Incremental Impact of Investment Decisions on Council Tax and Rents

This indicator shows the change in Council Tax and Rents necessary to support increased spending on the capital account year on year. This is achieved by taking the difference between:-

- the capital plans used to calculate last years' prudential indicators; and
- the current capital plans.

The loan charges on that difference are then expressed as the change to Council Tax or Rents which would be necessary to support those charges.

Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rent Levels								
	2015/16	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Original	Actual	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
General Services	**£ 7.95**	**£ (1.53)**	£ (2.07)	£ 2.86	£ 3.81	£ 3.25	£ 1.58	£ 4.49
HRA	**£ 0.32**	**£ (0.08)**	£ (1.61)	£ (1.72)	£ 2.98	£ 2.06	£ 0.97	£ 0.21

The figures in 1.1 and 1.2 above are based on the latest Capital Plans presented to Council.

1.3 HRA Ratios

The following indicator identifies the ratio of overall debt on the HRA account compared to annual house rent revenue.

HRA Debt as a % of Gross Revenue							
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 154,065	£ 159,097	£ 195,708	£ 217,586	£ 231,054	£ 231,074	£ 229,648
HRA revenues £000's	£ 23,257	£ 24,882	£ 26,712	£ 28,644	£ 30,700	£ 31,083	£ 31,789
Ratio of debt to revenues %	662%	639%	733%	760%	753%	743%	722%

The following indicator identifies the ratio of overall debt on the HRA account per HRA dwelling.

HRA Debt per Dwelling							
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 154,065	£ 159,097	£ 195,708	£ 217,586	£ 231,054	£ 231,074	£ 229,648
Number of HRA dwellings	6,833	6,864	6,992	7,179	7,301	7,304	7,307
Debt per dwelling £	£ 22,547	£ 23,178	£ 27,990	£ 30,309	£ 31,647	£ 31,637	£ 31,428

2. Prudential Indicators for Capital Expenditure

2.1 Estimated Capital Expenditure

This indicator shows the gross capital spend included in the relevant capital plans.

Capital Expenditure							
	2015/16 Actual £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's
General Services							
Resources	£ 7,941	£ 11,073	£ 7,871	£ 13,159	£ 12,143	£ 17,807	£ 10,116
Education, Community & Economy	£ 9,772	£ 23,293	£ 15,820	£ 5,535	£ 1,556	£ 519	£ 519
Health & Social Care	£ 85	£ 127	£ 452	£ 150	£ 150	£ 150	£ 203
Business Transformation	£ 1,074	£ 208	£ 120	£ 3,900	£ 6,000	£ 2,100	£ -
Unallocated		£ -	£ -	£ -	£ -	£ -	£ 657
Total General Services	**£ 18,872**	**£ 34,701**	**£ 24,263**	**£ 22,744**	**£ 19,849**	**£ 20,576**	**£ 11,495**
Total HRA	**£ 12,859**	**£ 18,393**	**£ 41,945**	**£ 27,095**	**£ 19,434**	**£ 6,711**	**£ 5,758**
Combined Total	**£ 31,731**	**£ 53,094**	**£ 66,208**	**£ 49,839**	**£ 39,283**	**£ 27,287**	**£ 17,253**

2.2 Financing of Capital Expenditure

This indicator shows how the Capital Expenditure forecasts are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital Expenditure and Available Financing							
	2015/16 Actual £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's
Capital Expenditure							
General Services	£18,872	£34,701	£ 24,263	£22,744	£19,849	£20,576	£11,495
HRA	£12,859	£18,393	£ 41,945	£27,095	£19,434	£ 6,711	£ 5,758
Total	**£31,731**	**£53,094**	**£ 66,208**	**£49,839**	**£39,283**	**£27,287**	**£17,253**
Financed by:							
Capital receipts	£ 1,843	£ 5,232	£ -	£ -	£ -	£ -	£ -
Capital grants	£11,481	£11,735	£ 9,022	£ 9,523	£ 9,523	£ 8,641	£ 8,641
Capital reserves	£ -	£ -	£ -	£ 3,900	£ 6,000	£ 2,100	£ -
Developer/Other Contributions	£11,089	£ 6,884	£ 6,586	£ 3,090	£ 2,242	£ 2,182	£ 1,319
Net financing need for the year	**£ 7,318**	**£29,243**	**£ 50,600**	**£33,326**	**£21,518**	**£14,364**	**£ 7,293**

2.3 Estimated Capital Financing Requirement

This indicator measures the Council's maximum underlying need to borrow for capital purposes and other long term liabilities over the next three years.

Capital Financing Requirement (CFR)							
	2015/16 Actual £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's
Capital Financing Requirement							
CFR – General Services	£ 99,959	£ 116,877	£ 122,939	£ 125,503	£ 124,020	£ 128,063	£ 125,919
CFR – HRA	£ 154,065	£ 159,097	£ 195,708	£ 217,588	£ 231,058	£ 231,089	£ 229,675
CFR – PFI Schemes	£ 56,180	£ 54,972	£ 53,659	£ 52,233	£ 50,683	£ 48,998	£ 47,167
Total CFR	**£ 310,204**	**£ 330,946**	**£ 372,306**	**£ 395,324**	**£ 405,761**	**£ 408,150**	**£ 402,761**
Movement in CFR	**£ (1,006)**	**£ 20,742**	**£ 41,360**	**£ 23,018**	**£ 10,437**	**£ 2,389**	**£ (5,389)**
Movement in CFR represented by							
Net financing need for the year (previous table)	£ 7,318	£ 29,243	£ 50,600	£ 33,326	£ 21,518	£ 14,364	£ 7,293
Less Scheduled Debt Amortisation	£ (7,204)	£ (7,293)	£ (7,927)	£ (8,882)	£ (9,531)	£ (10,290)	£ (10,851)
Less PFI Finance Lease Principal Payments	£ (1,120)	£ (1,208)	£ (1,313)	£ (1,426)	£ (1,550)	£ (1,685)	£ (1,831)
Movement in CFR	**£ (1,006)**	**£ 20,742**	**£ 41,360**	**£ 23,018**	**£ 10,437**	**£ 2,389**	**£ (5,389)**

3. Prudential Indicators for Prudence

3.1 Net Borrowing Requirement

This indicator shows the amount of external borrowing required to finance the current debt outstanding on capital projects.

Net Borrowing Requirement							
	2015/16 Actual £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's
External Debt							
Debt at 1 April	£ 234,706	£ 237,272	£ 258,472	£ 298,962	£ 326,808	£ 334,873	£ 338,865
Actual/Expected change in Debt	£ 2,566	£ 21,200	£ 40,490	£ 27,846	£ 8,065	£ 3,992	£ (1,394)
Other long-term liabilities (OLTL)	£ 57,300	£ 56,180	£ 54,972	£ 53,659	£ 52,233	£ 50,683	£ 48,998
Actual/Expected change in OLTL	£ (1,120)	£ (1,208)	£ (1,313)	£ (1,426)	£ (1,550)	£ (1,685)	£ (1,832)
Actual/Expected Gross Debt at 31 March	**£ 293,452**	**£ 313,444**	**£ 352,621**	**£ 379,041**	**£ 385,556**	**£ 387,863**	**£ 384,637**
The Capital Financing Requirement	**£ 310,204**	**£ 330,946**	**£ 372,306**	**£ 395,324**	**£ 405,761**	**£ 408,150**	**£ 402,761**
Under / (over) borrowing	**£ 16,752**	**£ 17,502**	**£ 19,685**	**£ 16,283**	**£ 20,205**	**£ 20,287**	**£ 18,124**
Investments							
Cash & Cash Equivalents	£ 13,355	£ 10,000	£ 10,000	£ 10,000	£ 10,000	£ 10,000	£ 10,000
Short-Term Investments	£ 54,985	£ 64,985	£ 64,985	£ 64,985	£ 64,985	£ 64,985	£ 60,000
Total Investments	**£ 68,340**	**£ 74,985**	**£ 74,985**	**£ 74,985**	**£ 74,985**	**£ 74,985**	**£ 70,000**

4. Prudential Indicators for External Debt

4.1 Operational Boundary

This is the limit beyond which external debt is not normally expected to exceed and will be the focus of day to day treasury management. Typically, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

For this Council:-

- the Operational Boundary for Borrowing has been calculated to equate directly to the value of the CFR for General Services and HRA combined, over each of the next 5 financial years (2016/17 to 2021/22); and
- the Operational Boundary for Other Long-Term Liabilities has been calculated to equate directly to the in-year CFR for Other Long-Term Liabilities, given the known contractual provisions for the repayment of debt within the Council's two PPP agreements.

Table 10: Operational Boundary

	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's
Operational Boundary - Borrowing	£275,974	£318,647	£343,091	£355,078	£ 359,152	£ 355,594
Operational Boundary - Other long term liabilities	£ 54,972	£ 53,659	£ 52,233	£ 50,683	£ 48,998	£ 47,167
Total	**£330,946**	**£372,306**	**£395,324**	**£405,761**	**£ 408,150**	**£ 402,761**

Should the Operational Boundary be breached, for example as a result of a decision taken to borrow in advance (should market conditions indicate that it is prudent to do so), this will be reported to Council at the next available opportunity.

4.2 Authorised Limit of Total External Debt

This indicator sets the limit for total external debt.

In an active Treasury Management policy it is sometimes prudent to borrow in advance of need if interest rates are expected to rise.

In order to continue to service the ongoing external debt and finance the current capital programmes the Council needs to increase its external borrowing to £384.042 million by 31 March 2022. Within the Capital Plans, there are assumptions regarding capital receipts and developer contributions which when applied to the Council's capital plans reduce the Council's borrowing requirements. However, the realisation of these capital receipts and developer contributions carry inherent uncertainty around both the timing and value of each receipt/contribution, given that they are largely dependent upon economic and market activity which are outwith the Council's control. Therefore, in order to calculate the Authorised Limit for Borrowing, these capital receipts and developer contributions have been added to the Capital Financing Requirement, to give the Council flexibility to fully borrow in advance of need (if market conditions support this action) should these receipts and contributions be unable to be realised in the short term. This therefore reflects a level of borrowing which, while not desired, could be afforded but is not sustainable.

Council is therefore asked to approve that, rather than restrict borrowing to £275.974 million for 2016/17, £318.647 million for 2017/18, £343.091 million for 2018/19, £355.078 million for 2019/20, £359.152 million for 2020/21 and £355.594 million for 2021/22, that permission be granted to borrow up to the 2021/22 Authorised Limit for borrowing of £384.042 million as shown in the table below), if market conditions support this action.

Adopting this approach will secure lower costs for future years but care will be taken to ensure that the cost of carry is minimised and that the maturity structure of all debt is sufficiently robust to ensure that the Capital Financing Requirement at 31 March 2022 remains achievable.

Authorised Limit						
	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
	£000's	£000's	£000's	£000's	£000's	£000's
Authorised Limit - Borrowing	£ 384,042	£ 384,042	£ 384,042	£ 384,042	£ 384,042	£ 384,042
Authorised Limit - Other long term liabilities	£ 54,972	£ 53,659	£ 52,233	£ 50,683	£ 48,998	£ 47,167
Total Debt	**£ 439,014**	**£ 437,701**	**£ 436,275**	**£ 434,725**	**£ 433,040**	**£ 431,209**

Reconciliation of calculation of Authorised Limit for borrowing:-

Reconciliation of Authorised Limit for Borrowing	
	£000's
CFR - General Services at 31 March 2021	£ 128,063
CFR - HRA at 31 March 2021	£ 231,089
Capital Receipts 2016/17 unrealised to date	£ 6,306
Capital Receipts 2017/18 to 2021/22	£ -
Developer/Other Contributions 2016/17 Unrealised to date	£ 3,799
Developer/Other Contributions 2017/18 to 2021/22	£ 14,785
Authorised Limit for Borrowing	**£ 384,042**

5. Prudential Indicators for Treasury Management

5.1 Adoption of the CIPFA Treasury Management Code of Practice

The adoption of CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* is an indication of a clear, integrated and prudent approach to Treasury Management.

5.2 Upper limits on Fixed and Variable Interest Rates

This indicator limits the amount of external debt that may be held at fixed or variable rates. These limits are proposed to be as follows:-

Upper Limits on Exposure to Fixed and Variable Interest Rates 2017/18	
Interest rate exposures	**Upper Limit**
Limits on fixed interest rates based on gross debt	100.00%
Limits on variable interest rates based on gross debt	30.00%
Limits on fixed interest rates based on investments	100.00%
Limits on variable interest rates based on investments	100.00%

5.3 Maturity Structure of Borrowing

This indicator sets the upper and lower limits of the time scales within which external debt may be held.

The Treasury Management Code of Practice now requires that LOBO's with a call date in the next 12 months are classified as short-term borrowing rather than longer-term (10 year+) borrowing.

In addition, the Code also recommends that where an authority's debt is typically very long term (i.e. for a period of greater than 10 years), that authorities should break down the period in excess of 10 years into several ranges, for example 10 to 20 years, 20 to 30 years, etc.

With the above in mind, the proposed upper and lower limits for each maturity band are shown below, with the overall aim to ensure a spreading approach to avoid a cluster of high value loans maturing/requiring refinancing within a short period of time.

Maturity Structure of Borrowing 2017/18		
Maturity structure of fixed interest rate borrowing 2017/18	**Lower**	**Upper**
Under 12 months	0.00%	50.00%
12 months to 2 years	0.00%	50.00%
2 years to 5 years	0.00%	50.00%
5 years to 10 years	0.00%	50.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years and above	0.00%	50.00%
Maturity structure of variable interest rate borrowing 2017/18	**Lower**	**Upper**
Under 12 months	0.00%	30.00%
12 months to 2 years	0.00%	30.00%
2 years to 5 years	0.00%	30.00%
5 years to 10 years	0.00%	30.00%
10 years to 20 years	0.00%	30.00%
20 years to 30 years	0.00%	30.00%
30 years to 40 years	0.00%	30.00%
40 years to 50 years	0.00%	30.00%
50 years and above	0.00%	30.00%

5.4 Total Principal Sums Invested for Periods Longer than 364 Days

This indicator relates to the total level of investments held for periods longer than 364 days.

Principal Sums Invested for > 364 Days		
Limit		£50m

The current strategy as outlined in the body of these reports is to cash-back the Council's balance sheet reserves. It is expected that the majority of this will be in the form of 12 month fixed term deposits and/or certificates of deposit. The limit for prinicipal sums invested for > 364 days has been set at £50m to give the Council flexibility to extend the duration of such deposits on the margins, to e.g. 366 days or 13/14 months. As noted in the Investment Strategy section of this report, a thorough appraisal of the additional risk involved in extending the duration of any deposit (marginally) beyond the maximum suggested by Capita, against any enhanced value to the portfolio, will be undertaken prior to the placement of any deposit.