North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 3 MARCH 2016

SUBJECT OF REPORT: TREASURY MANAGEMENT STRATEGY 2016/17

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: MALCOLM COE, HEAD OF FINANCE & PROPERTY

KEY DECISION: N/A

RECOMMENDATION

The Audit Committee is requested to note the report and comment on:

1. i) the Treasury Management Strategy for 2016/17 as shown in Appendix 1
   ii) the Prudential Indicators for 2016/17 as shown in Appendix 2
   iii) the Minimum Revenue Provision policy for 2016/17 as shown in Appendix 3

1. SUMMARY OF REPORT

The purpose of the report is to present the council's treasury management strategy for the 2016/17 financial year for scrutiny by the Audit Committee as required by statute. The strategy incorporates the financial planning assumptions used within the financing of the capital programme.

This report also contains the proposed prudential indicators and the policy to be approved for making minimum revenue provision within the budget, which are also required by statute.

The report was presented to the Executive on the 2nd February.

2. POLICY

The council's budget process should ensure that all resources are planned, aligned and managed effectively to achieve the corporate aims and objectives of the authority. It is also essential to integrate treasury strategies into revenue and capital budget planning processes in order to optimise financial opportunities and minimise any risks which may be present.

3. DETAILS

3.1 Treasury Management Strategy 2016/17

The council's treasury management strategy, which can be seen in detail at Appendix 1, sets out the proposals and guidance that the council will use to manage its daily cash-flow

activities during the 2016/17 financial year. The council must give due regard to the management of these sums which are in excess of £700m p.a., to ensure that it is sufficiently able to balance the daily cash requirements for all operational services whilst still achieving the strategic outcomes required within the medium-term financial plan.

There is a clear link between this strategy and the financial impact upon various elements of the council's capital financing budget, for example, the borrowing strategy will affect how much borrowing the council plans to undertake and therefore how much external interest it will pay on its loans and the investment strategy is a key component upon how much interest the council could achieve on its investments compared to budgeted levels. The strategy therefore has two key components covering both investments and borrowing.

3.2 Investment Strategy

With respect to the investment strategy, the primary objective is, and will continue to be the security of all principal sums, although officers will manage cash balances appropriately within a range of robust constraints to provide a balance of security, liquidity and also return whilst at the same time mitigating risks where required.

The council continually assesses the various investment risks it faces in conjunction with the support of treasury advisors Arlingclose Ltd who have provided a range of financial services, advice and market intelligence to the council over recent years.

It is recognised that the financial markets have continued to offer low levels of interest rates since 2008 which has impacted on the council's ability to generate additional returns within its revenue budget over that period. In addition to which, the options of prioritising security or liquidity will often result in the reduction of the rate of return achievable on investment balances, thereby heightening the financial challenge even further.

Members will be aware that the council currently places investments with banks, building societies and money market funds, often as fixed-term cash deposits although it has also recently invested monies with the local authority property fund which has achieved higher yields than the traditional investment products over recent years.

The current investment strategy also does allow the council to also place investments in products such as gilts, treasury bills, bonds and certificates of deposit although no sums are held in these products at this time, largely because of market conditions and risk levels.

The majority of the council's investments are placed by the in-house treasury team however the council also utilises the services of a cash manager for a small part of its portfolio with the aim of introducing diversity and the opportunity to achieve higher returns on longer-term balances where there are no operational constraints such as those faced by the in-house team. All aspects of treasury activities are continually reviewed to ensure optimum performance, this area is included and covered by the strategy.

At this time it is proposed that no significant amendments be made to the council's existing investment strategy for the forthcoming year as it is felt that it still offers the council sufficient scope to place investments appropriately within the market even if conditions change or investment opportunities arise over the course of the year.

However it is proposed that some individual counter-party limits for UK-based institutions whose security ratings are at appropriate levels, be increased marginally to allow for periods

of increased surplus cash-flows. These predominantly occur in the first half of the financial year and the lack of capacity within counter-parties not only causes operational difficulties but also can reduce the rate of return on such cash balances because of the lack of suitable capacity.

3.3 Borrowing Strategy

The summary below identifies the estimated level of borrowing that will be required to be undertaken during the period of the council's medium term financial plan in order to fund both the schemes currently included within the approved capital programme and also those identified as a key council priority.

	2015/16 £000	2016/17 £000	2017/18 £000	2018/19 £000	2019/20 £000	**TOTAL £000**
Borrowing to be taken;						
- funded by NSC	4,335	3,015	7,306	6,000	1,500	**22,156**
- funded by RIF	7,214	0	0	0	0	**7,214**
- funded by City-Region D	2,715	9,870	0	0	0	**12,585**
- funded by HCA	1,700	0	0	0	0	**1,700**
	11,628	9,870	0	0	0	**21,499**
TOTAL BORROWING	**15,963**	**12,886**	**7,306**	**6,000**	**1,500**	**43,655**

As can be seen above the overall level of borrowing required over the period is estimated to be £43.655m, with approximately £28.849m being required to finance capital expenditure before the end of March 2017.

The table also shows that of the £43.655m to be borrowed, only £22.156m will be funded from within the council's revenue budget. Sufficient provision has been included within the medium term financial plan to cover both the interest and the capital repayment charge.

Although the remaining £21.499m will initially be charged to the council's revenue budget, it is intended that these costs will ultimately be funded through external sources such as the Revolving Infrastructure Fund, the City-Region Deal and the Homes and Communities Agency.

Members will be aware that if there are any delays in achieving practical completion on any of the externally funded schemes, then this could result in an unbudgeted charge to the council's own accounts as reimbursement would also be delayed. The revenue budget is also dependent upon the council receiving Section 106 receipts in accordance with planned timescales. The potential risk to the revenue budget would be in excess of £1.5m p.a.

As noted above, this summary and all of the borrowing calculations only reflect proposals which are included within the approved capital programme which is considered elsewhere within the agenda for this meeting. Should any further borrowing or forward funding decisions be made over these levels then Council approval will be required and also additional revenue resources will need to be identified to fund debt repayment costs. In addition the council's prudential indicators would also need to be revisited in accordance with the requirements of the Prudential Code in order to provide the assurances of affordability.

3.4 Prudential Indicators

Under the provisions of the Local Government Act 2003, and the associated CIPFA Prudential Code for Capital Finance in Local Authorities, certain ‘Prudential Indicators’ relating to the revenue implications of capital programme decisions need to be considered when setting the revenue and capital budgets. These indicators provide information to Members on the affordability of borrowing plans, and the sustainable impact upon the council’s revenue budget.

In addition the Treasury Management Code of Practice also requires certain ‘Indicators’ relating to treasury activities to be approved, both sets of Indicators are detailed in Appendix 2.

3.5 Policy for Minimum Revenue Provision

The council is also required to determine a policy to ensure the “prudent” provision for the repayment of all long-term borrowing. The DCLG has published guidance on what constitutes prudent provision, which requires the full council to approve an annual MRP statement before the start of each financial year.

Shown at Appendix 3 is the proposed policy for calculating the MRP for 2016/17. This policy assumes that the council will continue to make MRP based on the regulatory option 1 for all expenditure incurred before 1st April 2008 and also any capital expenditure funded by supported borrowing since that time.

In addition, it is proposed that the MRP calculation for capital expenditure funded by unsupported borrowing in the previous financial year, i.e. 2015/16, will be based upon the useful economic life of the assets procured. The council will retain the option of choosing to defer the annual MRP charge on strategic infrastructure assets until such time as they become operational, thereby reducing the charge to the council’s revenue budget in the year after financing.

Appendices

1. Treasury Management Strategy for 2016/17
2. Prudential Indicators for 2016/17
3. Minimum Revenue Provision Policy for 2016/17

4. CONSULTATION

The proposed strategy remains largely unchanged from council practices over recent years and therefore offers Members the assurance surrounding key controls, a specific workshop dedicated to the 2016/17 treasury management strategy will be provided to the Audit Committee prior to 3 March 2016. This session will be jointly hosted by officers and Arlingclose, the council’s current external advisors.

5. FINANCIAL IMPLICATIONS

Financial implications are contained throughout the report and advise on the impact on both the annual revenue budget as well as the balance sheet.

6. RISK MANAGEMENT

Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets. It is proposed that the priority of the Treasury Management Strategy will be the reduction of risk to safeguard public resources.

7. EQUALITY IMPLICATIONS

N/a

8. CORPORATE IMPLICATIONS

The safeguarding of public money is critical to the council's reputation, and the measures contained within the report are intended to address public concerns and ensure an appropriate balancing of return on investment against security and risk management.

9. OPTIONS CONSIDERED

N/a

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BACKGROUND PAPERS

None

Treasury Management Strategy for 2016/17

1 INTRODUCTION

The council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires it to approve a treasury management strategy before the start of each financial year.

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

The Authority manages 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 council's treasury management strategy.

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

Any external investment managers employed by the Council are required, contractually, to comply with this Strategy.

2 STRATEGY OVERVIEW

2.1 The suggested strategy for 2016/17 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the council's treasury advisors, currently Arlingclose Ltd. The strategy covers:

- Section 3 – current and expected treasury portfolios
- Section 4 - the annual investment strategy
- Section 5 - the annual borrowing strategy
- Section 6 - other treasury management matters

3 CURRENT & EXPECTED TREASURY PORFOLIOS

3.1 Current portfolio

The council's current treasury portfolio, as at 31st December 2015 is as follows.

LONG-TERM DEBT	Principal £m		Ave Rate	Ave Term
Fixed Rate - PWLB	£124.23m	£124.23m	4.55%	1-38 Years
Other Long-Term Liabilities; - Ex Avon Loan Debt - Other (incl leasing)	 £15.65m £3.05m	 £18.70m	 6.15% 6.77%	 1-31 Years 1-14 Years

	TOTAL DEBT	£142.93m		
SHORT-TERM INVESTMENTS	**Principal £m**		**Ave Rate**	**Ave Term**
Managed In-House; - Banks - Building Societies	 £29m £44m	 £73m	 1.09% 0.84%	 1-23 Mths 1-12 Mths
Cash Managed by Tradition; - Banks - Local Authority - Building Societies	 £4m £5m £22m	 £30m	 1.93% 1.42% 1.17%	 25 Mths 27 Mths 2-24 Mths
	TOTAL INVESTMENTS	**£103.00m**		
	TOTAL NET DEBT	**£39.93m**		

The maturity profile of the council's borrowing and investments is as follows.

MATURITY PROFILE	LONG-TERM DEBT £m	SHORT-TERM INVESTMENTS £m	NET (INVEST) DEBT £m
Maturing Jan to March 2016	5.27	-38.00	-32.73
Maturing 2016/17 & 2017/18	8.94	-65.00	-56.06
Maturing 2019 to 2020	1.10	0.00	1.10
Maturing 2020 to 2025	15.85	0.00	15.85
Maturing 2025 to 2035	56.18	0.00	56.18
Maturing 2035 to 2045	50.59	0.00	50.59
Maturing after 2045	5.00	0.00	5.00
TOTALS	**142.93**	**-103.00**	**39.93**

3.2 Expected cash-flow changes

The cash flow forecasts assume no new external borrowing will be undertaken during the remainder of the current financial year, instead this borrowing will be deferred and taken during 2016/17. This decision will have no impact on the various capital schemes as they will still continue and will be financed from internal resources – the related capital projects include transport schemes and school and leisure projects.

The decision of whether, and when, to actually take external borrowing will be made in light of current and forecast interest rates.

3.3 Budget Implications

The budget for investment income in 2016/17 is £1.242 million, based on an average investment portfolio of £82 million at an average interest rate of 1.50%. This is reflective of the additional income target of £0.210m included within the council's medium term financial plan.

The council's corporate budget for long-term debt interest paid on its own loans in 2016/17 is £7.137 million, based on an average debt portfolio of £130 million at an average interest rate of 5.5%. This budget reflects the saving of £0.190m identified within the medium term financial plan.

The council's budgets held for the repayment charge to its revenue budget in 2016/17 total £8.812 million.

The council's budgets held for the interest and debt repayment charges in respect of the Avon debt total £1.517 million.

For the purpose of setting the budget, it has been assumed that new investments will be made between the ranges of 0.25% and 2.5%, and that new long-terms loans will be borrowed between the ranges of 1.75% to 4.75% all of which are dependent upon the size and lengths of the loans.

Clearly if there are any changes in the levels of investments placed and borrowing undertaken; actual interest rates generated from those forecast; or the timing profiles of borrowing or investments, then the performance against budget will be correspondingly different.

4 ANNUAL INVESTMENT STRATEGY 2016/17

At any point in time the council holds surplus funds, which represent income received in advance of expenditure in addition to balances and reserves held. In the past 12 months, the council's investment balance has ranged between £35m and £113 million. Both the CIPFA Code and the CLG Guidance require councils to invest their funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

Guidance prescribes that the following issues should be considered when setting and approving the Strategy.

4.1 Investment criteria and limits

The council defines the following as being of "high credit quality" (as per the CLG Guidance), subject to the monetary and time limits shown.

	Overall Limit*	**In-house Limit**	**Tradition Limit**	**Time Limit**
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is:				
AAA	***£30m***	£30m	£0m	10 years
AA+	***£25m***	£25m	£0m	5 years
AA	***£22m***	£22m	£0m	4 years
AA-	***£20m***	£16m	£4m	3 years
A+	***£18m***	£14m	£4m	2 years
A	***£16m***	£12m	£4m	2 years
A-	***£13m***	£9m	£4m	364-day
The Council's bank accounts	***Net £9m***	Net £9m	£0m	Overnight
UK building societies whose lowest long-term rating is BBB and societies without credit ratings, that have an asset size of more than **£0.4bn**	***£10m***	£6m	£4m	364 days

UK building societies whose lowest long-term rating is BBB and societies without credit ratings, that have an asset size of more than **£1bn**	***£10m***	£6m	£4m	2 years
Money market funds[1] and similar pooled vehicles whose lowest published credit rating is AAA	***£15m***	£15m	£0m	1 year
UK Central Government	***no limit***	unlimited	unlimited	no limit
UK Local Authorities[2]	***£15m***	£10m	£5m	25 years

The council defines the following as being of "high credit quality" (as per the CLG Guidance), subject to the monetary and time limits shown.

[3]* limits shown are per organisation
[1] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[2] as defined in the Local Government Act 2003

The maximum that could be lent to any one organisation (other than the UK Government) will be £30 million. This will limit the potential loss in the case of a single bank. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

There is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation that meets the credit rating criteria above. This reflects a lower likelihood that central government will support failing banks following the Independent Commission on Banking report, as well as the removal of restrictions on local authority purchases of corporate bonds.

4.2 Current bank account

Members will be aware that the current banking contract is held with Barclays Bank. Balances held within these accounts are excluded from investment award criteria and do not count towards investment totals.

4.3 Specified Investments

Specified investments are those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines specified investments as those:

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

The Council's definitions of "high credit quality" do not include any references to minimum individual and support ratings.

4.4 Non Specified Investments

Any investment that does not meet all of the criteria for Specified Investments is classed as a Non-Specified Investment.

Non-specified Investments, therefore relate to investments;

- in foreign currencies,
- that are defined as capital expenditure by legislation (such as company shares)
- to low credit quality bodies
- that exceed 12 months

The council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation (such as company shares or corporate bonds).

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.

Long-term investments
The maximum duration of the investment will depend upon its lowest published long-term credit rating, time limits are included within the table above.

Long-term investments will be limited to 50% of the counter-party limit (except the UK Government), therefore the combined value of short-term and long-term investments with any organisation will not exceed the limits for specified investments in paragraph 4.1 above.

4.5 Limits for Non Specified Investments

The council is required to set a limit, expressed as either a sum of money or as a percentage of total investments with regard to Non Specified Investments. This can range from 0 to 100%. Within that limit, the following category limits for non-specified investments will apply:

Type of Non Specified Investments	Limit	In-house	Tradition
Non-Specified exposure	Up to 100%	£150m	£30m
Investments for periods of > 1 year	Up to 100%	£50m	£15m

4.6 Building Societies

UK building societies without credit ratings will be considered to be of “high credit quality”, but subject to a lower cash limit and shorter time limit than rated societies. They provide the council with the opportunity to spread financial risk across a broader range and number of financial institutions which allows individual counter-party risk to be set at lower levels.

The council takes additional comfort from the building societies’ regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the council’s deposits would be paid out in preference to retail depositors. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

It is proposed that no investments will be made with building societies that hold a long-term credit rating lower than BBB or equivalent, due to the increased likelihood of default implied by this rating. However, for the purpose of the 2016/17 Investment Strategy the council will treat building societies as “high credit quality” if they should have an asset value greater than £0.4bn.

4.7 Money Market Funds

Money market funds are pooled investment vehicles consisting of instruments similar to those used by the council such as cash deposits. They are highly liquid and have the added advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the council.

Due to the liquidity and the high level of rating awarded the returns of the investments are often low however they are extremely useful as an alternative to instant access call accounts and therefore should be used within the balanced strategy. Should any MM Funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

4.8 Property Funds

The council has invested £5m with the Local Authorities Property Fund, (managed by the CCLA). The CCLA provide a range of pooled money market funds, some of which are created specifically for the public sector and cover asset classes such as Equities, Bond, Property or Cash. The council's investment was placed into the property related asset class which has achieved a rate of return of approximately 7-8% over recent years.

Although the CCLA does not have any form of rating or financial support criteria awarded to it, something which is currently required for all other investments, the organisation was established in 1958 and has a strong approach to stewardship and ethics.

The council's treasury advisers, Arlingclose Ltd are entirely comfortable with the CCLA property fund and currently have 43 other clients who invest with the organisation. They suggest that this investment should be viewed as a long-term term investment on a 5-year rolling horizon and recommend that Members focus upon the potential income return and not be distracted by the capital fluctuations in the share values. The advisers have also confirmed that such an investment would offer some accounting advantages compared with other property investments and because it represents a way of diversifying the investment portfolio away from focusing entirely upon bank credit risk.

4.9 Credit Ratings

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

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

Credit ratings are obtained and monitored by the council's treasury advisers on at least a monthly basis, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,

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

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

The council’s investments are normally senior unsecured liabilities of the borrower, and the credit rating of the investment is therefore normally identical to the credit rating of the counterparty. However, where a credit rating agency awards a different rating to a particular class of investment instruments, the council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

4.10 Other Information on the Security of Investments

Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, asset size, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

4.11 Investment Instruments

Investments may be made using any of the following instruments:

- interest paying bank accounts
- fixed term deposits
- call or notice deposits (where the council can demand repayment)
- callable deposits (where the bank can make early repayment) – subject to an overall limit of £25 million
- certificates of deposit
- property funds
- treasury bills and gilts issued by the UK Government
- bonds issued by multilateral development banks (e.g. the EIB)
- shares in money market funds

4.12 Foreign Countries

Investments in foreign countries will be limited to those that hold a AAA, AA+ or AA sovereign credit rating from all three major credit rating agencies, and to a maximum of £12 million per country, this limit to be divided between the in-house team (£8m) and cash manager Tradition (£4m). There is no limit on investments in the UK whatever the sovereign credit rating.

Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria, and will count against the limit for both countries. Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain’s Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia Bank) will be classed as UK banks due to their substantial UK franchises and the arms-length nature of the parent-subsidiary relationships.

Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

4.13 Liquidity Management

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

4.14 Benchmarks to be Adopted

Both treasury teams will be benchmarked during the financial year in order to monitor the performance of both the manager and the types of investment being used. The benchmarks to be used are;

- Tradition UK Ltd — 7 Day Notice Rate
- In-House team — Information from Treasury Advisers

4.15 Planned Investment Strategy for 2016/17

The council's current investment strategy allows surplus cash balances to be managed by two treasury teams each having distinct and separate controls and flexibilities. This allows the council to spread risk by not only investing in different financial products, but also utilising experienced external cash managers within the marketplace, who do not have the constraints and limitations of managing the council's daily cash-flows. The treasury teams are;

- Tradition UK Ltd
- In-house Treasury Team

The council's annual cash-flow forecast will be used to divide surplus funds into three categories;

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

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

Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term

deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations. It is anticipated that the council's in-house team will also administer these funds.

Any cash that is not required to meet any liquidity need can be invested for the ***longer- term*** with a greater emphasis on achieving returns that will support spending on council services. Security remains important, as any losses from defaults will impact on the total return, but liquidity is of lesser concern, although it should still be possible to sell investments, with due notice, if large cash commitments arise unexpectedly. The council currently employs an external fund manager that has both the skills and resources to manage the risks inherent in a portfolio of long-term investments. This allows the council to diversify its investment portfolio and obtain maximum returns from the different types of surplus cash. It is assumed that the majority of longer-term cash-flow balances will be invested by the council's cash fund manager, i.e. Tradition or in products which offer longer-term returns such as property funds.

Members should note that 'counter-party' risk is still the council's largest areas of risk which needs to be addressed, and it will continue to be managed in various ways; with credit ratings; and limits on individual institutions, groups and countries.

It is proposed that all counter-parties which the council invests funds with, should have at least a minimum credit rating or be considered as having "high credit quality" by having an asset base greater than £0.4bn, and if the investment increases in risk, because of either the size or length of the deposit, then a counter-party with a higher rating should be used.

In addition, maximum investment limits with individual counter-parties will continue to be applied, including the continuation of 'group' limits for those counter-parties with subsidiaries. This reduces the council's overall exposure to the one group.

It is also proposed that the council should continue to be given the flexibility to invest with financial institutions who are not solely based within the UK, as this does widen the number of available counter-parties with whom the council can invest and also diversify investments away from just the UK. However, in order to mitigate any potential risks from overseas institutions it is proposed that investments are only placed in those countries with the highest credit rating and also continue to operate within a system of 'country' limits in order to reduce the council's overall exposure to any one particular country.

With short-term interest rates currently much lower than long-term rates, due consideration may also be given to using surplus funds to make early repayments of long-term borrowing. In addition to the savings on the interest rate differential, this strategy will also reduce the council's exposure to credit risk and interest rate risk. However, before any such decisions are made then the council will also quantify and assess early termination penalties chargeable by lenders in order to determine whether the potential course of action actually represents good value for the council tax payers.

5 BORROWING STRATEGY

5.1 Introduction

As shown in paragraph 3.1 above, the council currently holds £124.233 million of long-term loans, all of which are from the PWLB.

5.2 Borrowing Requirement

Following a review of the council's existing approved capital programme together with the incorporation of the proposed new schemes, it is anticipated that the total **borrowing requirement for the period of the MTFP totals £43.655m**.

5.3 Sources of Borrowing

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

- Public Works Loan Board
- Local Capital Finance Company (LCFC)
- Revolving Infrastructure Fund
- Local Growth Fund
- any institution approved for investments above
- any other bank or building society on the Financial Services Authority list

5.4 Resources to finance Borrowing costs

The increase in borrowing costs in respect of the North Somerset Council funded elements will be charged to the council's revenue budget in accordance with proper accounting practice, and will be funded by a combination of growth included within the Medium Term Financial Plan and also contributions from services budgets via their invest-to-save proposals.

Members will be aware that although the council will initially incur borrowing costs in respect of the City-Region Deal projects, it is anticipated that these will be largely reimbursed by the Economic Development Fund (EDF), subject to criteria being met. An agreement has been sign based upon a series of core principles, which include reimbursements being offered to local authorities using an EIP interest rate; payments being made the year after practical completion of the entire scheme; the EDF having sufficient funds being available to distribute for completed schemes and also claw-back mechanisms in relation to past reimbursements received in order to fund future project costs of new schemes.

It should be noted that variations due to timing differences and interest rates are likely to generate additional unbudgeted costs within the council's revenue budget although efforts will be made to minimise these wherever possible. Members should also note the requirement of the council to underwrite the borrowing costs should the EDF have insufficient funds available, although this risk is regarded as low.

The council will incur borrowing costs in respect of projects funded from the Revolving Infrastructure Fund, although it is anticipated that these will be reimbursed by developers upon receipt of Section 106 contributions. It will therefore be important to monitor the delivery of planned housing developments and the associated financial obligations as delays could result in unbudgeted costs being charged to the council's revenue budget.

Failure to receive reimbursement from the City-Region Deal programme or the planned Section 106 receipts would significantly impact upon the council's revenue budget.

5.5 Debt Instruments

Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest
- lender's option borrower's option (LOBO) loans, subject to a maximum of £10m
- municipal bonds

As an alternative to borrowing loans, the council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative
- Revolving Infrastructure Grants

5.6 Planned Borrowing Strategy for 2016/17

Section 1 of the Local Government Act 2003 gives the power for local authorities to borrow for the purposes of their functions or for the prudent management of their financial affairs. The timing of any borrowing is not tied rigidly to the need for cash to pay for expenditure that was going to be financed by borrowing but there needs to be a reasonable link. An authority would need to show a need to borrow the cash in the reasonable future.

It is proposed that the council will consider PWLB borrowing as the primary source of finance for 'unsupported' capital projects and the newly formed Local Capital Finance Company as the second source, with decisions being made to ensure the best value for the taxpayer.

The proposed strategy will be to consider anticipated future life of the asset being financed in order to align it to the capital repayment chargeable to the revenue budget, but the current maturity profile of the council will also be considered to ensure that no more than £7.5m will be repayable in any one financial year. In addition, it is projected that the length of the borrowing will also follow the current yield curve which is showing that the longer rates have lower rates, therefore representing best value to taxpayers.

Although the council's current long-term PWLB borrowing is held within fixed rate loans, variable rate borrowing will also be considered around this time to hedge against interest rate risk within the investment portfolio.

It will be necessary to review borrowing rates throughout the financial year in order to determine the optimum time to borrow so that the lowest rates can be achieved. It is anticipated that the council will continue to benefit from a reduction of 0.2% on the Public Works Loan Board published interest rates following confirmation of acceptance into its Certainty Rate scheme.

The Public Works Loan Board does allow 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. It is possible that the council could potentially take advantage of this and replace some higher rate loans with new loans at lower interest rates where this will either lead to an overall net saving or reduce risk. The calculation would need to take into account the level of the premium charged as this could be a significant cost.

6 OTHER TREASURY MANAGEMENT MATTERS

The revised CLG Investment Guidance also requires the council to note the following three matters each year as part of the investment strategy:

6.1 Treasury management advisors

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

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

6.2 Investment training

The needs of the council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. A recruitment exercise is currently underway to appoint a new Project Accountant with specific responsibilities for treasury management in order to bring additional staffing capacity into the in-house treasury team. This will enable greater focus and attention to be applied to this important area.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, ACCA, the Association of Corporate Treasurers and other appropriate organisations.

6.3 Investment of money borrowed in advance of need

The council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the council 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 council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £255 million. The maximum periods between borrowing and expenditure is expected to be two years, although the council does not link particular loans with particular items of expenditure.

6.4 Other options considered

The CLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance and Property, having consulted the Executive Member for Finance, 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.

Alternative	Impact on income and expenditure	Impact on risk management
Adopt a narrower definition of “high credit quality” and/or shorter time limits	Interest income will be lower	Reduced risk of losses from credit related defaults
Adopt a wider definition of “high credit quality” and/or longer time limits	Interest income will be higher	Increased risk of losses from credit related defaults
Reduce the ability to place investments overseas	Reduced number of counterparties will result in more investments with the DMO, interest income will be lower	Reduces the risk of investments managed outside of UK govt controls
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Prudential Indicators for 2016/17

1.1 INTRODUCTION

Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and also the Prudential Code for Capital Finance in Local Authorities, the council is required follow the elements within the Guidance and set 'indicators' which demonstrate that it follows good practice and has implemented and operates within appropriate systems of control before making capital financing and treasury management decisions.

1.2 PRUDENTIAL INDICATORS: PRUDENTIAL CODE

The Prudential Code sets out the factors that must be considered by each local authority when making decisions about capital investment and associated borrowing. Using the same decision making process as is used for setting the annual revenue and capital budgets, the prudential indicators for the period of the MTFP must be set and approved before the beginning of each financial year.

Prudential indicators for financing costs, external debt and capital expenditure should not be set or revised in isolation from one another but be considered together when compiling the MTFP and in setting the tax level for each year.

In setting or reviewing the prudential indicators each local authority is required to have regard to the following matters;

- Affordability, e.g. implications for Council Tax
- Prudence and Sustainability, e.g. implications for external borrowing
- Value for Money, e.g. option appraisal
- Stewardship of Assets, e.g. asset management planning
- Service Objectives, e.g. the key objectives of the council
- Practicality, e.g. achievability of the forward plan

Shown below are the recommended prudential indicators for the period of the MTFP.

1.2.1 Capital Expenditure

The first indicator details the Capital Expenditure to be incurred by the council. The proposed programmes for 2016/17 and 2017/18 are shown along with the revised programme for 2015/16 and the actual spend for 2014/15.

Capital Expenditure				
	2014/15 Actual £000	**2015/16 Revised £000**	**2016/17 Estimate £000**	**2017/18 Estimate £000**
Authority Total	46,380	60,689	63,099	52,907

1.2.2 Ratio of Financing Costs to Net Revenue Stream

The second indicator estimates the ratio of financing costs compared to the net revenue stream for the current and future years, and the actual figures for 2014/15 are;

Ratio of Financing Costs to Net Revenue Stream				
	2014/15 Actual %	2015/16 Revised %	2016/17 Estimate %	2017/18 Estimate %
General Fund	9.54	9.01	10.97	12.49

The estimates of financing costs include current commitments and the assumed level of supported and unsupported borrowing contained within the proposed capital programme for the period 2016 to 2018.

1.2.3 Capital Financing Requirement

The capital financing requirement measures the authority's underlying need to borrow for a capital purpose for the authority for the current and future years, together with the actual capital financing requirement as at 31st March 2015 included within the statutory accounts;

Capital Financing Requirement				
	2014/15 Actual £000	2015/16 Revised £000	2016/17 Estimate £000	2017/18 Estimate £000
General Fund	135,941	148,112	157,268	162,915

In accordance with best professional practice, North Somerset Council does not associate borrowing with particular items or types of expenditure, and has at any point in time, a number of cash-flows, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending.

In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose. The capital financing requirement indicators shown above reflect the totality of the capital expenditure contained within the proposed capital programme for 2016/17.

1.2.4 Incremental Impact

The final prudential indicator shows the impact on the incremental impact of capital investment decisions proposed in the budget, over and above capital investment decisions that have previously been taken by the council.

Incremental Impact		
	2015/16 £	**2016/17 £**
For the Band D Council Tax; - Incremental impact of Capital Investment Decisions on Council Tax	£0.87	£3.22

The figures for each of the years shown above represent the increase over the 2015/16 base budget, not the increase each year. They include any assumptions made about unsupported borrowing proposals for 2016/17. It should be noted that the 2016/17 figure will reflect a part-year effect of the interest charge, and the 2017/18 figure will be higher and this would include both the full-year effect of the interest charge, as well as an element of principal repayment charged to the revenue accounts.

1.3 TREASURY MANAGEMENT INDICATORS: TREASURY CODE

The council is asked to approve the following indicators:

1.3.1 Operational Boundary

The council is required to set for the forthcoming year, and the following two financial years limits for its total external debt separated into borrowing and other long-term liabilities, plus a total.

The **boundary** should be the council's best estimate of the most likely, prudent, maximum levels of debt to be held during the years in question. The boundary can be exceeded in the short-term should the council need to undertake temporary borrowing, or debt rescheduling, but should not be exceeded for new long-term borrowing proposals.

Operational Boundary	2016/17	2017/18	2018/19
Long-term borrowing	£190m	£204m	£218m
Other long-term liabilities (avon debt, leases, temporary borrowing etc)	£51m	£51m	£51m
Total Operational Boundary	**£241m**	**£255m**	**£269m**

1.3.2 Authorised Limit

The **authorised limit** is the 'affordable borrowing limit' which the council is required to set in section 3 of the Local Government Act 2003, and cannot be exceeded without acting ultra vires. The authorised limit is set at a higher level than the operational boundary to provide headroom for unexpected borrowing requirements.

Authorised Limit	2016/17	2017/18	2018/19
Long-term borrowing	£200m	£215m	£235m
Other long-term liabilities	£55m	£55m	£55m
Total Authorised Limit	**£255m**	**£270m**	**£290m**

1.3.3 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 will be as follows.

Interest Rate Exposure	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposures (net debt)	**£221m**	**£240m**	**£259m**
Upper limit on variable interest rate exposures (net debt)	**£35m**	**£40m**	**£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*.

1.3.4 Maturity structure of borrowing

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

Maturity Structure of Borrowing	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within five years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

This indicator applies to the financial years 2016-2019. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

1.3.5 Principal sums invested for periods longer than 364 days

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

Investments longer than 364 Days	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£85m	£65m	£59m

Minimum Revenue Provision Policy for 2016/17

Introduction

When the council funds capital expenditure by long-term borrowing, the costs are charged to the council tax payer in future years, reflecting the long-term use of the assets procured. There are two elements to this cost – the interest on borrowing is charged in the year it is payable, and the principal (or capital) element is charged as a "minimum revenue provision" (MRP).

The amount of MRP to be charged was determined by regulation, although the council is also allowed to make an additional "voluntary" charge to the revenue account.

The *Local Authorities (Capital Finance and Accounting) (England) Regulations 2008* which came into force on 31st March 2008, replaced the detailed statutory rules for calculating MRP with:

> **28.** A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent.

The Department for Communities and Local Government (DCLG) has issued guidance on what constitutes prudent provision and that requires Council to approve a statement each year of the policy on making MRP.

The DCLG guidance makes a distinction between supported and unsupported borrowing (i.e. whether or not the funding is included in the capital financing block of the Revenue Support Grant settlement). MRP for historic supported borrowing allocations is calculated at 4% of expenditure per annum, being the amount included within the RSG settlement. Supported borrowing allocations are no longer used by the Government, they usually now provide funding through one-off grants to councils.

MRP Charge for 2016/17

The MRP charge in 2016/17 for capital expenditure funded by supported borrowing allocations, incurred to 31st March 2016 (i.e. the end of the previous financial year), will continue to be calculated in accordance with the methodology prescribed by the regulations, which is one of the options allowed by the DCLG guidance. The calculation is:

	£000
Est Capital Financing Requirement at 31.03.16*	114,410
Less MRP to be charged in 2015/16	4,576
	109,834
Total Statutory MRP to be charged in 2016/17	**4,393**

* The Capital Financing Requirement measures the council's underlying need to borrow for capital purposes, and is the council's cumulative capital expenditure not financed by other means, less the total MRP made in previous years.

This sum excludes the outstanding debt administered by Bristol City Council in respect of the former Avon County Council, which will incur a separate MRP charge of approximately £652k in 2016/17.

In addition to the Statutory Provisions above, MRP for assets funded by unsupported borrowing is calculated by reference to the expected life of the assets, which is a more prudent approach to repayment of debt.

	£000		£000
Voluntary MRP for expenditure 2009/10	14,506		587
Voluntary MRP for expenditure 2010/11	8,621		629
Voluntary MRP for expenditure 2011/12	10,361		442
Voluntary MRP for expenditure 2012/13	3,491		175
Voluntary MRP for expenditure 2013/14	2,034		92
Voluntary MRP for expenditure 2014/15	4,963		267
			2,192
New expenditure financed by unsupported borrowing during 2015/16:			
- NSC funded costs ave life of up to 9 years	14,263	x 11%	1,562
Voluntary MRP for expenditure incurred in 2015/16			1,562
Total Voluntary MRP charged in 2016/17			**3,754**

The overall total estimated MRP charge for the Council in 2016/17 is therefore projected to be **£8.799m**.

The council's gross capital financing expenditure budget has been set at £8.812m comprising £8.160m for the council's costs and a further budget of £652k in respect of the Avon Loan Debt costs.

Capital expenditure incurred during 2016/17 will not be subject to a MRP charge until 2017/18, or until the year the asset becomes operational.