Treasury Management Strategy for 2017/18 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 2017/18 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 <u>Current portfolio</u>

The council's current treasury portfolio, as at 31st December 2016 is as follows.

LONG-TERM DEBT	Principal £m		Ave Rate	Ave Term
Fixed Rate - PWLB	£118.96m	£118.96m	4.2%	1-38 Years

Other Long-Term Liabilities; - Ex Avon Loan Debt - Other (incl leasing)	 £15.02m £2.55m	 £17.57m	 6.15% 6.77%	 1-31 Years 1-14 Years
TOTAL DEBT		**£136.53m**		
SHORT-TERM INVESTMENTS	**Principal £m**		**Ave Rate**	**Ave Term**
Managed In-House; - UK Banks - Overseas Banks - Building Societies	 £15.0m £31.5m £9.0m	 £55.5m	 1.07% 0.63% 0.88%	 12 Months 7 Months 8 Months
Cash Managed by Tradition; - UK Banks - Building Societies - Local Authority/ DMO	 £10m £15m £5m	 £30m	 1.06% 0.89% 1.42%	 11 months 8 Months 2–3 Years
LONG-TERM INVESTMENTS	**Principal £m**		**Ave Rate**	**Ave Term**
Managed In-House; - CCLA	£5m	£5m	4.1%	3-5 Years
TOTAL INVESTMENTS		**£90.50m**		
TOTAL NET DEBT		**£46.03m**		

The maturity profile of the council's PWLB borrowing and investments is as follows (excluding Avon loan debt).

MATURITY PROFILE	**LONG-TERM DEBT £m**	**SHORT-TERM INVESTMENTS £m**	**NET (INVEST) DEBT £m**
Maturing Jan to March 2017	£6.6m	£30.0m	(£23.4m)
Maturing 2017/18 & 2018/19	£8.4m	£55.5m	(£45.6m)
Maturing 2020 to 2021	£1.1m	£5.0m	(£3.9m)
Maturing 2021 to 2026	£13.3m		£13.3m
Maturing 2026 to 2036	£51.3m		£51.3m
Maturing 2036 to 2046	£33.2m		£33.2m
Maturing after 2046	£5.0m		£5.0m
TOTALS	**£118.9m**	**£90.5m**	**£28.4m**

3.2 <u>Expected cash-flow changes</u>

The cash flow forecasts above are based on the current portfolio. There still remains a requirement to borrow in 2016/17. The decision of whether, and when, to actually take external borrowing will be made in light of current and forecast interest rates.

3.3 <u>Budget Implications</u>

There are three main changes to the council's corporate budget in relation to treasury activities in 2017/18, an increase to interest receivable, reduced MRP contributions and an increase to interest payable.

- An additional income target of £0.2m was included within the council's medium term financial plan in 2016/17 in relation to interest receivable. The increase reflects the additional return forecast on the CCLA property fund over and above traditional investments.

- The MRP budget for 2017/18 has been reduced by £790k to £7.3m as a result of a more prudent change in policy. Please see Appendix 3 for more details.

- Interest payable has been increased by £105k in 2017/18 in relation to borrowing costs in support of the capital programme.

<u>Prospects for interest Rates</u>

Arlingclose have been appointed the councils treasury advisors and part of their service is to assist the council in formulating a view on interest rates. Their central case is for base rate to remain at its historic low of 0.25%.

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.13
Arlingclose Central Case	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.42
3-month LIBID rate														
Upside risk	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.19
Arlingclose Central Case	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.29
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.36
1-yr LIBID rate														
Upside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.24
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.70	0.85	0.90	0.90	0.90	0.95	0.68
Downside risk	-0.15	-0.15	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.26
5-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.50	0.45	0.45	0.45	0.50	0.50	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.57
Downside risk	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.48
10-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.95	0.90	0.90	0.90	0.95	0.95	0.95	1.00	1.05	1.10	1.15	1.20	1.25	1.02
Downside risk	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.48
20-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	1.50	1.45	1.45	1.45	1.50	1.50	1.50	1.55	1.60	1.65	1.70	1.75	1.80	1.57
Downside risk	-0.55	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.58
50-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	1.40	1.35	1.35	1.35	1.40	1.40	1.40	1.45	1.50	1.55	1.60	1.65	1.70	1.47
Downside risk	-0.55	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.58

The underlying assumptions of this forecasts are based on global and UK specific factors. In the global environment there are uncertainties following the results of the US election and uncertainties surrounding what policies the new administration will pursue. With the possibility of more barriers to international trade.

A moderate global economic recovery is expected with improved prospects in developing and emerging markets and reduced concern about Chinas near term prospects following policy to support growth. As a result the IMF have forecast an improved forecast in global economic growth from 3.1% in 2016 to 3.4% in 2017.

Domestically in the medium term forecasts are dominated by the negotiations to leave the EU. And in the longer term dependent upon the agreements the Government is able to secure with the other EU countries. The fall in sterling over the last 6 months is likely to push up CPI in the early part of 2017 and above the 2% target. This is likely to slow growth with the Office for Budget responsibility revising growth forecasts for 2017 from 2.2% to 1.4%.

The economic outlook and more specifically the low interest rate environment will impact upon the council’s finances. The fall in interest rates will result in lower investment returns in 2017/18 and remain so in the medium term as deposits begin to mature and are replaced by investments reflective of the new lower base rate. The council has achieved average returns of 1.0% in 2016/17, this is expected to drop to around 0.5% on traditional bank and building society deposits.

The proposed additional £5m investment into a pooled fund will help diversify the portfolio and protect against future movements in interest rate and partially mitigate against this drop in forecast returns.

Conversely the reduction of the Bank of England base rate will be beneficial for any new long term borrowing with PWLB rates 20 basis points lower than this time last year. An environment of falling interest rates also increases the premiums repayable on early repayment of PWLB loans.

4 ANNUAL INVESTMENT STRATEGY 2017/18

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
Pooled Investment funds	***£5m per Fund Type***	*£5m per Fund type*	£0m	N/A

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.

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 <u>Limits for Non Specified Investments</u>

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 <u>Building Societies</u>

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.

It is proposed that no investments will be made with building societies that hold a long-term credit rating lower than BBB or equivalent and with asset value less than £0.4bn, due to the increased likelihood of default implied by this rating.

4.7 <u>Money Market Funds</u>

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 Pooled Funds

Pooled funds are investments from many individual investors aggregated for the purpose of investment and managed by professionals. Funds can vary in asset class from equities, property, bonds or a mixed portfolio with varying levels of each.

The council currently has invested £5m with the Local Authorities Property Fund, (managed by the CCLA). The council's investment was placed into the property related asset class which has achieved a rate of return of approximately 4-5% over recent years.

Although unrated such funds are not exposed to Bail-in legislation and offer greater diversification and greater returns. The council's treasury advisers, Arlingclose Ltd are entirely comfortable with Pooled Funds. 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.

It is proposed that pooled investments are limited to £5m in any one of the Fund Types mentioned above to limit exposure, provide further diversification, protect against changes in interest rates and limit exposure to Bail-in legislation.

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 parentsubsidiary 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 2017/18

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 inhouse 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.

4.16 Loans to social enterprises and local businesses

In support of the councils overall strategy which includes the MTFP, treasury management and capital strategies, loans to social enterprises and local businesses will be considered. Where regeneration and infrastructure investments in North Somerset clearly contribute to the delivery of growth financing will be considered on projects that offer adequate security and returns.

5 BORROWING STRATEGY

5.1 Introduction

As shown in paragraph 3.1 above, the council currently holds £118.96 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 £38.952m**.

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 – Municipal Bond Agency)
- 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.

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 2017/18

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 and additionally due to the fall in interest rates.

Restructuring debt

Whilst in an environment of low interest rates the opportunity to repay PWLB borrowing using cash balances and realise any net gains is limited due to the size of the premiums repayable on early repayment and the loss of income from those cash balances. At present the premium resulting from the early repayment of the council's portfolio amounts to £33.6m or around £2m per loan.

For the same reasons above the early repayment of the councils share of the Ex-Avon loan debt would result in additional costs over and above the current interest payments. However the transfer of this debt into North Somerset Council control is being discussed.

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 £273 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