READING BOROUGH COUNCIL
REPORT BY DIRECTOR OF FINANCE

TO:	AUDIT & GOVERNANCE COMMITTEE		
DATE:	25 JANUARY 2018	AGENDA ITEM:	9
TITLE:	PREPARING FOR THE 2018/19 BUDGET DRAFT TREASURY STRATEGY & INVESTMENT STATEMENT FOR 2018/19		
RESPONSIBLE COUNCILLOR:	COUNCILLOR STEVENS	PORTFOLIO:	CHAIR OF AUDIT & GOVERNANCE
SERVICE:	ALL	WARDS:	BOROUGHWIDE
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1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1 This report sets out some of the matters that will be relevant to the final 2018/19 Budget Report.

1.2 This report enables some pre budget scrutiny as recommended by CIPFA of the current draft the Annual Treasury Strategy & Investment Statement. Of necessity, elements of the strategy are technically complex, and Audit & Governance Committee Scrutiny enables some councillor consideration in public committee ahead of decisions that need to be made in February.

1.3 The Treasury Strategy Statement will in due course form part of the Council's overall budget proposals, presented as part of the Budget Report to Council in February.

1.4 The draft Treasury Strategy may see some amendments to ensure it is consistent with the remainder of the budget proposals, but major change impacting 2018/19 is not anticipated. In introducing the item at committee, a short presentation will highlight key treasury management and related issues for 2018/19.

2. RECOMMENDED ACTION

2.1 That the committee considers the draft Treasury Strategy & Investment Statement, prior to setting the 2018/19 budget.

3. POLICY CONTEXT

3.1 The Council is required to have a Treasury Strategy & Investment Statement in place in order to comply with legislative requirements and recommended

professional practice. As the strategy is linked to the Council's overall budget strategy, it is formally considered and approved each year as part of the budget. There are some changes this year as set out in the draft strategy statement.

4. THE PROPOSAL

4.1 The draft Treasury Management Strategy Statement is attached in Annex A. This report enables Audit & Governance to consider the draft statement for 2018/19 (at Annex A) ahead of Policy Committee & Council in February.

4.4 There will be a brief presentation at the Committee meeting to explain the key treasury and other issues the council is likely to face over the next year. There are a few gaps (marked "to follow") or things that may change in the draft Treasury Strategy as the budget proposal for 2018/19 is yet to be finalised.

5. CONTRIBUTION TO STRATEGIC AIMS

A key objective of the Council's Corporate Plan is to remain financially sustainable to deliver its key service priorities. Proper management of the Council's Treasury position and property investments helps support the overall achievement of the Council's financial objectives and service strategies.

6. COMMUNITY ENGAGEMENT AND INFORMATION

The Council does not directly consult with the community on these particular issues, though occasionally receives queries about its treasury and property activity to which an appropriate response is made.

7. EQUALITY IMPACT ASSESSMENT

An EIA is not relevant at this time.

8. LEGAL IMPLICATIONS

None, at this stage.

9. FINANCIAL IMPLICATIONS

As set out elsewhere in this report and appendices.

10. BACKGROUND PAPERS

The statement has been prepared using a template provided by Arlingclose, adapted for Reading's needs
CIPFA Treasury Management & Prudential Codes and guidance notes

Treasury Management Strategy Statement 2018/19

1. The Treasury Management Strategy Statement (TMSS) is an annual statement the Council is required to approve each year of our intended treasury activity, setting constraints under which that activity will (usually) operate. Given the technical nature of the subject, by way of introduction the statement is intended to explain

- How the Council tries to minimise net borrowing costs over the medium term
- How we ensure we have enough money available to meet our commitments
- How we ensure reasonable security of money we have lent and invested
- How we maintain an element of flexibility to respond to changes in interest rates
- How we manage treasury risk overall

1.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Department for Communities and Local Government (DCLG) issued revised *Guidance on Local Council Investments* in March 2010 that requires the Council to approve an Investment Strategy before the start of each financial year. During the Autumn of 2017 both CIPFA and DCLG consulted on revisions to the Code and statutory guidance, but at the time of writing, whilst the final CIPFA Code had been published, the final revised statutory guidance was not available. 2018/19 is seen as a transition year, and whilst CIPFA's Treasury & Capital Management Panel has issued a statement recommending both CIPFA codes are implemented as soon as possible, but recognised that the new formal requirement to have a capital strategy may not be fully implemented until 2019/20. In this code we have implemented changes to the practical extent reasonably possible[1] at the time of preparation. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the DCLG Guidance.

1.2 The purpose of this TMSS is, therefore, to approve the:

- Treasury Management Strategy for 2018/19
- Annual Investment Strategy for 2018/19
- Approve a (newly required) Capital Investment Strategy (to follow - not available for A&G)

[1] As usual the TMSS has been based on a template provided by Arlingclose. For practical reasons their *template covered the requirements of the 2010 CLG Investment Guidance and the 2011 CIPFA TM Code of Practice, including the Treasury Management Indicators. It could not reflect changes to DCLG Guidance which were published after the template was issued. We have made reasonable practical additions and amenments to take account of the later published guidance.*

- Prudential Indicators for 2018/19, 2019/20 and 2020/21 (with some updates to 2017/18)
- MRP Statement (in connection with debt repayment)

2. Introduction

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

2.2 Revised strategy: In accordance with the DCLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Council's capital programme or in the level of its investment balance.

3. External Context

3.1 Economic background: The major external influence on the Council's treasury management for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

3.2 Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

3.3 In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

3.4 **Credit outlook:** High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

3.5 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low.

3.6 **Interest rate forecast:** The Council's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

3.7 Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

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

3.9 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.3%, and that new long-term loans will be borrowed at an average rate of 1.5% rising to 1.75% by the end of the year (reflecting short term borrowing at up to 0.75% and long term borrowing at 1.75%%. (In practice we are not budgeting for lending, and these borrowing rates are higher than is currently achievable, so include some cover for possible (modest) interest rate rises.

4. Local Context

4.1 On 31 December 2017, the Council held £352.2m of borrowing and 23.4m of treasury investments. This is set out in further detail at ***Annex B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.17 Actual £m	31.3.18 Estimate £m	31.3.19 Forecast £m	31.3.20 Forecast £m	31.3.21 Forecast £m
General Fund CFR	301.7	335.8	447.7	479.9	513.8
HRA CFR	191.3	187.1	189.8	190.1	190.5
Total CFR	493.0	522.9	637.5	670.0	704.3
Less: Other debt liabilities *	- 31.8	- 30.8	- 29.8	- 28.8	- 27.0
Borrowing CFR	461.2	492.1	607.7	641.2	677.3
Less: External borrowing **	- 353.4	- 339.2	- 286.7	- 282.3	- 278.0
Internal (over) borrowing	107.8	152.9	321.0	358.9	399.3
Less: Usable reserves	- 81.4	- 80.0#	- 70.0#	- 65.0#	- 60.0#
Less: Working capital	- 26.4	- 25.0#	- 25.0#	- 20.0#	- 20.0#
Forecast New borrowing Need	-	- 47.9	- 226.0	- 273.9	- 319.3

* PFI liabilities & Finance Leases that form part of the Council's total debt
** shows only loans to which the Council is committed and excludes optional refinancing

Figures will need to be reviewed when the draft budget proposal has been finalised

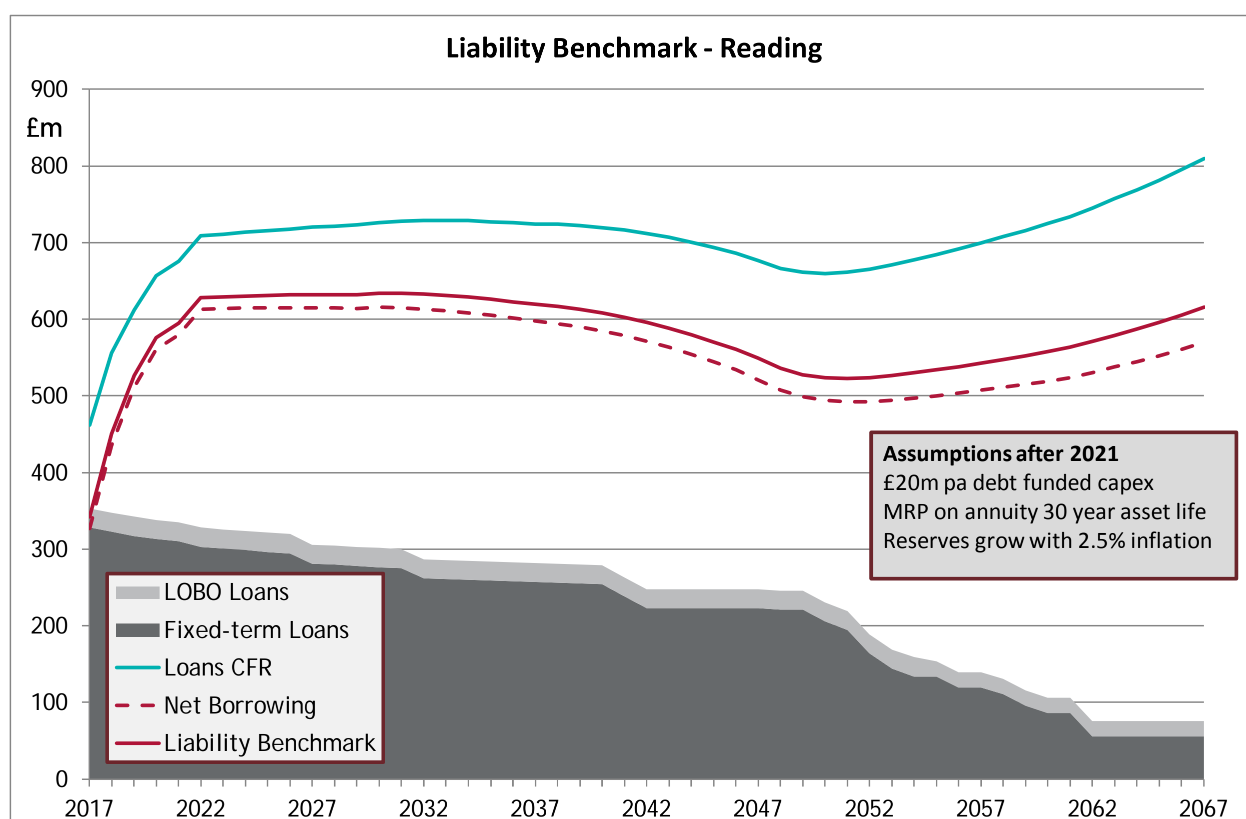
4.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. In recent years this has helped minimise net financing costs.

4.3 The Council has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £320m over the forecast period, including c.£50m {to be confirmed} by the end of this financial year, and a further £176m next year. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should

be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2018/19,and throughout the forecast period.

4.4 To assist with its long-term treasury management strategy, the Council and its advisers have created a liability benchmark, which forecasts the Council's need to borrow over a 50 year period. Following on from the medium-term forecasts in table 1 above, the benchmark assumes:

- capital expenditure funded by borrowing of £20m a year
- minimum revenue provision on new capital expenditure based on a 25 year asset life
- income, expenditure and reserves all increase by 2.5% inflation a year (i.e. in real terms the Council's financial position is broadly stable)



[Draft Liability Benchmark Chart from November discussion with advisor]- *updated chart to be provided for Policy Committee/Council.*

4.5 The chart shows borrowing needing to rise from the current £350m level to around £600m by the early years of the next decade. This very large increase reflects the Council's strategy to have a large capital programme funded by borrowing (which is in part revenue generating, to help fund the borrowing).

5. Borrowing Strategy

5.1 At 31 December, the Council held £352 million of loans, a slight decrease from the £359 million 12 months ago. The balance sheet forecast in table 1 shows that the Council expects to borrow up to c.£180m in 2018/19. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £520 million.

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

5.3 **Strategy:** [May need some {minor} amendment to reflect local circumstances in final version] Given the significant real cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

5.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk at least in the immediate financial year. The benefits of internal and short-term borrowing will continue to be monitored regularly against the potential for incurring additional costs by deferring longer term (fixed rate) borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

5.5 Alternatively, the Council may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

5.6 In addition, the Council may borrow short-term to cover unplanned cash flow shortages.

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
- Any other party that establishes a presence in the LA market not covered by the above categories (as agreed by the CFO on advice of Arlingclose)

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

Operating and finance leases and hire purchase

Private Finance Initiative

sale and leaseback

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

5.7 **Municipal Bonds Agency:** The UK Municipal Bonds Agency plc (MBA) was established in 2014 by the Local Government Association as an alternative to the PWLB. The Council, along with about 60 other authorities are shareholders. The MBA plans to issue bonds on the capital markets and lend the proceeds to local authorities. The Council approved the necessary cross guarantee arrangements to be able to participate in a bond issue some time ago. The MBA has been moving towards its initial bond issue for some considerable time, and provided our original rationale for investing remains true, subject to meeting the MBA's criteria the Council may be part of an MBA bond issue during the year. Should the terms of the cross guarantee arrangements have materially changed from those already agreed Policy Committee will need to approve the revised arrangements before proceeding.

5.8 **LOBOs:** The Council holds £25m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £20m of these LOBOS have options during 2018/19, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will

take the option to repay LOBO loans at no cost if it has the opportunity to do so.

5.9 During 2017/18, the Council has been contacted by a lender of £10m of the Council's LOBOS setting out outline terms to repay the loan, in a way that either the LOBO risk could be removed at no long term cost to the Council, or the opportunity taken to refinance the borrowing differently at a lower annual treasury cost, at least for the medium term financial strategy period. The proposal appears to have some merit, and the Council's treasury advisor has been asked to complete a due diligence report, with a view to proceeding with a repayment during 2018. The loans are the most expensive LOBO loans the Council currently has and amongst the Council's most expensive long term borrowing (although they were originally arranged at then reasonably low rates in the market). The premium the Council will have to pay to replace these loans can be accounted for over the remaining period of the original loans and on initial inspection appears to offer some long term, and possibly shorter term advantages to the Council. As in previous years, total borrowing via LOBO loans will be limited to £40m, though assuming this restructure proceeds our actual LOBO portfolio will reduce to £15m.

5.10 Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

5.11 Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

6. Investment Strategy

6.1 The Council sometimes holds significant invested funds, representing income received in advance of expenditure and also has some limited balances and reserves. During 2017/18 to 31 December, the Council's investment balance has ranged between £19.8 and £70.8 million, and in the forthcoming year levels are generally expected to be between £15m and £25m (to ensure that we hold the minimum £10m liquid balance required to meet MIFID2 requirements, as well as the expected continuing holding of the CCLA property fund. Over the course of the year the balance could sometimes reach £50-£70m depending upon cash flow.

6.2 **Objectives:** Both the CIPFA Code and the CLG Guidance require the Council to invest it's treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

6.3 **Negative interest rates:** Should the UK enter into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

6.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council moved the majority of its short term cash holdings to money market funds in 2015/16. With Arlingclose, we will consider options to further diversify into more secure and/or higher yielding asset classes during 2018/19. This diversification will represent a continuation of the new strategy adopted over the last couple of years.

6.5 **Ethical Policy:** The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's Corporate Plan and values. This would include institutions with material links to:

- human rights abuse (e.g. child labour, political oppression)
- environmentally harmful activities
  (e.g. pollution, destruction of habitat, fossil fuels)
- socially harmful activities (e.g. tobacco, gambling)

These principles will be applied to investments made by the Council.

6.6 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved investment counterparties and limits

Counterparty		Cash limit	Time limit †
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£20m each #	10 years*
	AA+		5 years*
	AA		4 years*
	AA-		3 years*
	A+		2 years
	A		1 year
	A-		
The Council's current account, Lloyds Bank plc should circumstances arise when it does not meet the above criteria		£1m	next day***
UK Central Government (irrespective of credit rating)		unlimited	50 years**
UK Local Authorities (irrespective of credit rating)		£20m each	50 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher		£5m each	10 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings		£2m each	5 years
UK Building Societies without credit ratings		£10m each	1 year
Money market funds and other pooled funds (including the CCLA Property Fund)		Up to £20m each	n/a
Any other organisation, subject to an external credit assessment and specific advice from the Council's treasury management adviser		£5m each	3 months
		£1m each	1 year
		£100k each	5 years

#In practice balances with individual counterparties are likely to be significantly less than £20m.

6.7 During recent years, Arlingclose have developed criteria for identifying which smaller building societies appear to have the most robust financial position, and the current recommended have been added below. Note that some banks on the list below currently have a nil counter party limit. The Council's S151 officer has Council to amend the list below at short notice on the advice of Arlingclose (subject to the Treasury Strategy as a whole).

Table 3: Proposed Counterparty List {to be verified with Arlingclose}

Country/ Domicile	Counterparty	Maximum Counterparty Limit %/£m	Maximum Group Limit (if applicable) %/£m	Maximum Maturity Limit (term deposits and instruments without a secondary market)	Maximum Maturity Limit (negotiable instrument)
UK	Santander UK Plc (Banco Santander Group)	£10m		2 years	5 years
UK	Bank of Scotland (Lloyds Banking Group)	£20m	£20m	2 years	5 years
UK	Lloyds TSB (Lloyds Banking Group)	£20m		2 years	5 years
UK	Barclays Bank Plc	£20m		2 years	5 years
UK	HSBC Bank Plc	£20m		2 years	5 years
UK	Nationwide Building Society	£10m		6 months	5 years
UK	NatWest (RBS Group)	£0m	£5m (in the event the limit is raised)	2 years	5 years
UK	Royal Bank of Scotland (RBS Group)	£0m		2 years	5 years
UK	Coventry Building Society	£5m		6 months	n/a
UK	Leeds Building Society	£5m		100 days	n/a
UK	Darlington Building Society	£1m		100 days	
UK	Furness Building Society	£1m		100 days	n/a
UK	Hinckley & Rugby Building Society	£1m		100 days	n/a
UK	Leek United Building Society	£1m		100 days	n/a
UK	Loughborough Building Society	£1m		100 days	n/a
UK	Mansfield Building Society	£1m		100 days	n/a
UK	Market Harborough Building Society	£1m		100 days	n/a
UK	Marsden Building Society	£1m		100 days	n/a
UK	Melton Mowbray Building Society	£1m		100 days	n/a

UK	National Counties Building Society	£1m		100 days	n/a
UK	Newbury Building Society	£1m		100 days	n/a
UK	Scottish Building Society	£1m		100 days	n/a
UK	Stafford Railway Building Society	£1m		100 days	n/a
UK	Tipton & Coseley Building Society	£1m		100 days	n/a

6.8 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

6.9 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See 6.16 below for arrangements relating to operational bank accounts.

6.10 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

6.11 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

6.12 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made on the specific advice of the Treasury Advisor following an external credit assessment or to a maximum of £500,000 per company as part of a diversified pool in order to spread the risk widely. In

practice this form of lending is not currently envisaged, but the possibility of doing it has been included on Arlingclose advice.

6.13 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

6.14 **Pooled funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

6.15 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. At the current time the Council has not used such funds.

6.16 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore normally be kept below £1m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

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

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

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

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

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

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

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

The Council defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign

country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

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

Table 3: Non-specified investment limits

	Cash limit
Total long-term investments	£25m (including at least £15m in CCLA property fund)
Total investments without credit ratings or rated below A-	£20m (Including CCLA PF)
Total investments (except pooled funds) with institutions domiciled abroad rated below AA+	£0m
Total non-specified investments	£5m+ CCLA Funds

6.22 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be £[to follow - from main budget report or Robustness appendix] million on 31st March 2018. To avoid putting reserves at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £20 million (and normally for only short periods). A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit (as last year)
Any single organisation, except the UK Central Government	£15m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£12m per group
Any group of pooled funds under the same management	£12m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	5m in total
Registered Providers	£5m in total
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£5m in total
Money Market Funds	£20m each

6.23 **Liquidity management**: The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis 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.

6.24 Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the 2011 CIPFA Code or the CLG Guidance, the Council may also purchase property for investment purposes and may also make loans and equity investments to the Council's subsidiaries. Such loans and investments will be subject to the Council's formally agreed approval processes, which sits separately this treasury management strategy. When the final new MHCLG Guidance is issued the Council may need to review it's Commercial Property Investment Strategy. Similarly, the Council's support arrangements for Homes for Reading Ltd may need review, though as was reported when the arrangement was approved, the Company's activities are closely linked to the Council's Housing strategy.

The Council's existing non-treasury investments are set out in Appendix B. The Prudential Indicators below have at this stage only allowed for the Council's planned property purchases to the end of the 2018/19 financial year, as it will be appropriate to consider each year whether further purchases are appropriate.

7. Treasury Management Indicators

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

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit score	6.0

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. This target has been increased from £10m to £15m to take account of the requirement from 3 January 2018 normally to hold £10m for MIFID 2 related reasons

	Target
Total cash available within 3 months (above estimated cash flow requirements)	£15m

7.2 **Interest rate exposures**: This indicator is set to control the Council's exposure to interest rate risk. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments, as percentage of fixed rate debt).

	2018/19	**2019/20**	**2020/21**
Upper limit on fixed interest rate exposure	110%	110%	110%
Upper limit on variable interest rate exposure	50%	50%	50%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

7.3 **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	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	25%	0%
10 years and within 20 years	100%	40%
20 years and within 30 years	100%	
30 years and within 40 years	100%	
40 years and within 50 years	100%	
50 years and above	100%	

For the purpose of this indicator, time periods start on the first day of each financial year and the maturity date of borrowing is the earliest date on which the lender can demand repayment (with the next LOBO option dates treated as the repayment date). Although these limits have not been changed, the under 12 month limit will be reached during 2018/19 (if the whole £178m borrowing identified above were taken, together with other borrowing due to mature within a year). To avoid a breach, the Council will normally explore options with our Arlingclose to extend maturities should the under 12 month maturing actual borrowing exceed 20% of all borrowing (i.e. currently when such borrowing reaches about £80m).

7.4 **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 long-term principal sum invested to final maturities beyond the period end will be:

	2017/18	2018/19	2019/20	2020/21
Limit on principal invested beyond one year	£15m	£25m	£15m	£15m

(Note that Arlingclose advise that the limit for 2018/19 is set in line with the long-term investment limit under non-specified investments above. The limits for the later years are smaller, so limiting investments made for longer than 2/3 years).

8. <u>Other Items</u>

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

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

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

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

8.2 Policy on apportioning interest to the HRA: Reform of the Housing Revenue Account Subsidy system was completed at the end of 2011/12, when we were required to pay DCLG £147.8m. Prior to 2012/13 we were required to recharge interest expenditure and income attributable to the HRA in accordance with determinations issued by DCLG. The Council has adopted a policy that it will continue to manage its debt as a single pool using a similar regime that applied prior to self-financing which will set out how interest charges attributable to the HRA will be determined, because self-financing did not result in a material change to the average interest rate paid by the Council.

However, during 2016/17 and 2017/18 some technical details of the methodology have been adjusted to recognise that in essence the £147.8m of loans the Council borrowed at the time of self-financing were primarily taken for HRA debt, and therefore the operation of the single pool should not lead to the average interest rate being charged to the HRA being less than the average

rate on the remaining part of those loans (with the balance of HRA borrowing at the average of all other long term borrowing).

The HRA also has a notional cash balance which may be positive or negative. This balance is measured each month and interest transferred between the General Fund and HRA at the net average rate earned by the Council on its portfolios of treasury investments (excluding the CCLA Property Fund) and short-term borrowing

8.3 **Investment training:** The needs of the Council's treasury management staff for training in investment management are periodically considered especially when the responsibilities of individual members of staff change. Staff regularly attend training courses or seminars provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, or other appropriate organisations. There will need to be a review of overall training needs during 2018/19 because of wider staff changes anticipated within the Finance function. The new Chief Accountant will ensure this review is undertaken.

8.4 **Investment advisers:** The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. We have at least two meetings per annum with Arlingclose, and make contact whenever advice is needed on treasury or related matters (including related capital accounting issues – for example during 2017/18 Arlingclose have provided assistance in resolving audit queries, including those related to PFI financing).

8.5 **Investment of money borrowed in advance of need**: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the 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.

8.6 The total amount borrowed will not exceed the authorised borrowing limit of £520 million. The maximum period between borrowing and expenditure is expected to be less than 2 years, (as we would not normally borrow money that was not expected to be needed within the current or following financial year), although the Council does not link particular loans with particular items of expenditure.

9. Financial Implications

9.1 During 2017/18 the Council expects to earn around £60-70k on its cash balances. The estimate for investment income in 2018/19 is slightly higher (reflecting the November 2017 interest rate rise, but lower forecast cash balances) at c.£75k, based on an average investment portfolio of around £20 million at an interest rate just below 0.4%. The budget for debt interest paid in 2017/18 was £12.1 million but borrowing has been lower than forecast so costs will only be around £11.1m. The 2018/19 budget is £12.0m (of which £10.6m is currently committed), the overall budget being based on an average debt portfolio of £380 million at an overall average interest rate of 3.15%). If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different. The treasury position is managed as a whole, with the aim of operating within the agreed capital financing budget. A range of other lines are included; income on our CCLA Property Fund Investment, Interest on money lent to others (Reading Buses and Homes for Reading Ltd) as well as our MRP budget. £6.5m interest costs are estimated to be charged to the HRA.

9.2 Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director and Head of Finance, having consulted the Leadership believe 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
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
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 may 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 may 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 may be less certain

Prudential Indicators and MRP Statement 2018/19[2]

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Council's planned capital expenditure and financing may be summarised as follows. Further detail is provided in [the capital programme report pages X to X – in final Council Report].

Capital Expenditure and Financing	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
General Fund *(split by service if appropriate)*	70.6	145.8	125.5	93.8
HRA	12.0	25.3	15.6	8.7
Total Expenditure	82.6	171.1	141.1	102.5
Government Grants	17.0	26.7	25.3	6.8
Capital Receipts	3.3	7.0	4.2	1.0
S106	1.6	5.9	2.9	-
CIL	3.3	2.0	2.0	2.0
Borrowing	51.0	123.3	100.7	86.3
Major Repairs Allowance	6.2	6.2	6.0	6.4
Total Financing	82.4	171.1	141.1	102.5

[2] As indicated above the TMSS and this template covers the requirements of the 2011 CIPFA Prudential Code (as amended in 2012). It also covers the requirements of the latest Guidance on Minimum Revenue Provision for an annual MRP statement (England 2012). The latest code removed explicit reference to HRA indicators, but recommended local indicators were used where the HRA was significant. In practice we intend to continue with the original agreed suite, given the HRA' significance in Reading).

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

Capital Financing Requirement	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
General Fund	335.8	447.7	479.9	513.8
HRA	187.1	189.8	190.1	190.5
Total CFR	522.9	637.5	670.0	704.3

The CFR is forecast to rise by £175m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

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

Debt	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
Borrowing	387.0	493.0	556.0	597.0
Finance leases	<1.0	<1.0	<1.0	<1.0
PFI liabilities	30.8	29.8	28.8	27.0
Total Debt	**418.8**	**523.8**	**585.8**	**625.0**

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

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

Operational Boundary	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	**470**	500	530	560
Other long-term liabilities	**40**	40	40	40
Total Debt	**510**	**540**	**570**	**600**

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

Authorised Limit	2017/18 Limit £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Borrowing	480	**520**	550	590
Other long-term liabilities	40	**40**	40	40
Total Debt	**520**	**560**	**590**	**630**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream {to follow}	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
General Fund				
HRA *(if applicable)*				

We need the final 3 year MTFS agreed to calculate these ratios

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

revenue budget requirement arising from the capital programme proposed [earlier in this report].

Incremental Impact of Capital Investment Decisions	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
General Fund - increase in annual band D Council Tax			
HRA - increase in average weekly rents *(if applicable)*			

This indicator has been dropped by the new code and suggest we drop it

Appendix Y – Annual Minimum Revenue Provision Statement 2018/19

Summary Introduction

This statement was last substantially revised in 2016/17. The revised approach was considered similarly prudent to the previous one overall as debt will be paid off over the same period of time (albeit to a different profile, or in the case of older debt and historically supported borrowing over a 50 year fixed period, (rather than never being fully repaid).

In addition the policy was extended to include a similar approach with PFI assets, and in connection with a funding strategy for our equal pay liability. The revised policy included some discretion in relation to capital receipts and making additional provisions. Over the life of assets all debt will be repaid, but the annuity method seeks to equalise total financing costs over the asset life with the consequence that generally less debt will be paid off in early years. These MRP arrangements have been applied since the 2015/16 financial year. Only minor changes have been made for 2018/19.

Statement of MRP approach

1. The Government's Capital Finance and Accounting Regulations require local authorities to make 'prudent annual provision' in relation to capital expenditure financed from borrowing or credit arrangements. This is known as Minimum Revenue Provision or MRP, but it is often referred to as a provision for "debt repayment" as a shorthand expression. The Government has also issued statutory guidance on MRP, to which the Council is required to have regard.

2. This policy applies to the financial years 2017/18 and 2018/19, and is intended to apply for years thereafter subject to annual review as part of the budget. Any interpretation of the Statutory Guidance or this policy will be determined by the Chief Finance Officer (taking advice as necessary from the Head of Legal & Democratic Services and the Council's treasury advisor, Arlingclose).

3. Principles of debt repayment provision - The term 'prudent annual provision' are not defined by the Regulations. However, the statutory Guidance says "the broad aim of prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant". The Guidance does not prescribe the annual repayment profile to achieve this aim, but suggests four methods for making MRP which it considers prudent, and notes that other methods are not ruled out. The Council regards the broad aim of MRP as set out above as the primary indicator of prudent provision, whilst recognising the flexibilities which exist in determining an appropriate annual repayment profile.

4. The Council considers that ‘prudent’ in this context does not mean the quickest possible repayment period, but has regard to the prudent financial planning and management of the of the overall financial position, recognising the flow of benefits from the capital expenditure, and other relevant factors.

5. This MRP Policy therefore takes account of the financial forecast in the Council’s medium term plans, and a general assessment by the Director of Finance of the likely position in the years after that in determining what is a prudent MRP in the circumstances. In particular, this takes account of the Council’s funding approach to equal pay settlements (paragraph 14 below) and the need for an orderly financial transition as the Council manages the grant reductions announced by Central Government through to 2019/20 (that in 2018/19 are linked to the NNDR Berkshire Pilot).

6. Consistent with the Statutory Guidance, the Council will not normally review individual asset lives used for MRP as a result of any changes in the expected life of the asset or its actual write off. Inevitably, some assets last longer than their initially estimated life, and others will not; the important thing is that the Direcor of Finance is satisfied that a reasonable estimate has been made at the time of capital expenditure. (Normally this will range between 5 years for some vehicles and IT equipment, though some assets in these categories could be longer, to 60 years for major new buildings (such as new school buildings). As a guide we use the following standard asset lives
   - major new buildings on Council owned land where a 40-60 year asset life (unless the design life is demonstrably shorter) will be appropriate
   - freehold land – 60 years
   - leasehold land – the life of the lease
   - major extensions to existing buildings, or major remodelling of infrastructure – where a 20-40 year asset life may be more appropriate (according to the design life of the extension/remodelling)
   - major refurbishment of existing buildings – where a 20 year life can reasonably be presumed
   - major transport infrastructure or regeneration schemes (i.e. new roads or major remodelling of junctions) – 30 years (or according to the design life of the infrastructure/regeneration if materially different)
   - other transport capital expenditure – 20 years
   - small items capitalised revenue expenditure – 10 years
   - vehicles, where typically a 5 year life will be reasonable for smaller vehicles; in some cases (e.g. refuse freighters 7-8 years, in line with maintenance contracts) a longer life will be appropriate

   but we will keep this categorisation under review, and individually consider all material asset additions funded from borrowing

7. General Fund - Borrowing funded assets from prior to 2007/08 – For this historic borrowing the Council does not hold detailed records that match borrowing to assets, and until 2015/16 had been making MRP at 4%pa on a reducing balance basis. For the reasons outlined in 3 & 5 above the Council now considers that an approach consistent with paying the remaining debt off at 2% of the 31/3/11 level pa for 50 years would now be appropriate, but for

the period 2015/16-2019/20 considers an annuity approach based on a 46 year annuity from 2011/12 provides an appropriate transition from its approach hitherto to the long term intended approach. Therefore from 2020/21 the annual MRP will be fixed at the same cash value so that the whole debt is repaid after 50 years (from 2007/08), subject to adjustment in the event of appropriation of land between the HRA and General Fund. Debt for this purpose is measured on the historic "credit ceiling" basis, so includes repayment of the adjustment in the basis of MRP on moving from the 1989 Act system in 2004 ("Adjustment A"). The total of MRP subject to this process can be adjusted when appropriations occur between the HRA and General Fund.

General Fund MRP policy: borrowing funded assets after 2007/08

8. The general repayment policy for new prudential borrowing is to repay borrowing within the expected life of the asset being financed. Normally asset lives will be a maximum of 20 years in the case of major refurbishment or transport infrastructure, but longer periods may be used for new buildings or other major assets where the council puts in place an appropriate long term funded cyclical maintenance programme. This is in accordance with the "Asset Life" method in the Guidance. The repayment profile will follow an annuity repayment method, (like many domestic mortgages) which is one of the options set out in the Guidance.

   This is subject to the following details:

   8.1 An average asset life for each project will normally be used. There will not normally be separate MRP schedules for the components of a building (e.g. plant, roof etc), unless other component accounting requirements (which rarely apply in Reading) indicate such an approach would be appropriate. Asset lives will be determined by the Director of Finance, taking advice from appropriate technical experts (within the Council wherever possible). A standard schedule of asset lives will generally be used, but where borrowing on a project exceeds £5m, specialist advice from appropriate external advisers may also be taken into account.

   8.2 MRP will commence in the year following the year in which capital expenditure financed from borrowing is incurred, except for single assets where over £1m financed from borrowing is planned, where MRP will be deferred until the year after the asset becomes operational. (In connection with this, the MRP for the Civic Offices was adjusted in 2015/16 so all the borrowing finance is repaid over the same (60 year) period starting in 2015/16, as the asset became operational in late autumn 2014.

   8.3 Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, at the discretion of the Director of Finance.

   8.4 If appropriate, shorter repayment periods (i.e. less than the asset life) may be considered for some or all new borrowing.

8.5 Where the Council incurs debt on the purchase of an investment property, in the event of a vacancy of tenancy, the Director of Finance may suspend MRP for up to 2 years, provided it is reasonable to assume a new tenant will be identified.

Housing Revenue Account MRP policy

9. The statutory MRP Guidance states that the duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on HRA assets. This is because of the different financial structure of the HRA, in which depreciation charges have a similar effect to MRP. However, since the Government's HRA self-financing settlement, which introduced a cap on HRA borrowing, which was established in April 2012, the Council has made a minimum revenue provision of 2% of outstanding debt. This will continue (though is seen as part of the depreciation charge in the HRA business plan). The charge ins any year will also take account of the HRA business plan, and the context of HRA debt within the authority as a whole (taking account of the Council's single debt pool approach to managing it's borrowings. (For the immediate future this means the charge will be at least the 2% minimum). In principle, the Council will also seek to deliver a reduction in HRA debt per dwelling (though our ability to do this may depend upon RTB volumes). Additional voluntary HRA debt repayment provision may be made from revenue or capital resources (that have been derived from the disposal of housing assets).

Concession Agreements and Finance Leases

10. From 2015/16 MRP in relation to concession agreements (e.g. General Fund PFI contracts) and finance leases will be calculated on an asset life method using an annuity repayment profile, consistent with the method for prudential borrowing in paragraph 8 above. The Director of Finance may approve that such debt repayment provision may be made from capital receipts rather than from revenue provision (subject to Policy Committee approval of the draft accounts outturn report).

MRP & Capital Receipts

11. Local authorities may also use capital receipts to repay any borrowing that was incurred to fund capital expenditure in previous years. The Chief Finance Officer will determine annually the most prudent use of Capital Receipts, taking into account forecasts for future expenditure and the generation of further receipts, and the Council's wider financial plans. If capital receipts are utilised to repay debt in year, the value of MRP chargeable will normally be reduced by the value of the receipts utilised.

13. Statutory capitalisation - Expenditure which does not create a fixed asset, but is statutorily capitalised, will follow the MRP treatment in the Government guidance, apart from any exceptions provided for below.

Cash flows

14. Where a significant difference exists between capital expenditure accrued and the actual cash flows, MRP may be charged based on the cash expended at the previous year end, as agreed by the Director of Finance. The reason for this is that, if expenditure has been accrued but cash payments have not yet been made, this may result in MRP being charged in the accounts to repay borrowing which has not yet been incurred.

Equal Pay settlements

15. During 2017/18 the Council has begun making payments in respect of its equal pay settlement liabilities. The MTFS envisages they are funded using capital receipts. Based on our current estimate of the liability, we currently hold enough receipts, but it is feasible that our estimate may change, as may use of receipts and we may find that not all the required receipts have yet been received. As there are risks to the timing and quantum of future capital receipts, as a risk management mechanism, MRP may be reduced in 2017/18 or 2018/19 if there are insufficient capital receipts to fund equal pay settlement costs in that (or the following year in the case of 2017/18). The revenue saving will then be used to meet the settlement costs.

16. Any such reduction will be made good by setting aside equivalent future capital receipts to provide for debt repayment, when there is a surplus of capital receipts available after funding equal pay settlements. As a minimum, any such reduction in MRP will be repaid over 20 years as a charge to revenue account on an annuity profile.

Capitalised loans to others

17. MRP on capitalised loan advances to other organisations or individuals will not normally be required. Instead, the capital receipts arising from the capitalised loan repayments will be used as provision to repay debt. (i.e. MRP will be made and funded from the agreed debt repayment) However, revenue MRP contributions would still be required equal to the amount of any impairment of the loan advanced.

Investments

18. Where investments are made in financial instruments that score as capital expenditure where the Council expects full repayment, no MRP will be made

Voluntary repayment of debt

19. The Council may make additional voluntary debt repayment provision from revenue or capital resources. In this case, the Director of Finance may make an appropriate reduction in the same or the following year's levels of MRP.

20. Where it is proposed to make a voluntary debt repayment provision in relation to prudential borrowing from 2007/08 under the asset life method, it may be necessary to decide which assets the debt repayment relates to, in order to determine the reduction in subsequent MRP. The following principles will be applied by the Director of Finance in reaching a prudent decision:

- where the rationale for debt repayment is based on specific assets or programmes, any debt associated with those assets or programmes will be repaid;
- where the rationale for debt repayment is not based on specific assets, debt representative of the service will be repaid, with a maturity reflecting the range of associated debt outstanding;

Subject to the above two bullet points, debt with the shortest period before repayment will not be favoured above longer MRP maturities, in the interests of prudence, to ensure that capital resources are not applied for purely short term benefits.

Capital expenditure incurred during 2017/18 will not be subject to a MRP charge until 2018/19.

Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2017, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	2018/19 Estimated MRP £
Capital expenditure before 01.04.2008		
Supported capital expenditure after 31.03.2008		
Unsupported capital expenditure after 31.03.2008		
Finance leases and Private Finance Initiative		
Transferred debt		
Loans to other bodies repaid in instalments		Nil
Total General Fund		
Assets in the Housing Revenue Account		Nil
HRA subsidy reform payment		
Total Housing Revenue Account		
Total		

The total CFRs in this table should match the estimates in the prudential indicators. Please delete

Annex A - Arlingclose Economic & Interest Rate Forecast January 2018

Underlying assumptions:

- The MPC increased Bank Rate in November 2017 to 0.5%. The rise was questionable based on the available economic data. Market rate expectations are broadly unchanged since the rise and policymakers continue to emphasise that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have revised lower the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2. Forecasts for future GDP growth have generally been revised downwards.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- More recent labour market data suggested that employment has plateaued, although house prices (outside London) appear to be relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger global and Eurozone economic expansions.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- The MPC increased Bank Rate largely to meet expectations they themselves created. Expectations for higher short term interest rates are now relatively subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.
- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.
- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.21
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.17
3-month LIBID rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.23
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.22
1-yr LIBID rate														
Upside risk	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.28
Arlingclose Central Case	0.70	0.70	0.70	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.78
Downside risk	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	-0.15	-0.26
5-yr gilt yield														
Upside risk	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.33
Arlingclose Central Case	0.75	0.80	0.80	0.80	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	1.15	0.92
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.35
10-yr gilt yield														
Upside risk	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.33
Arlingclose Central Case	1.25	1.25	1.25	1.25	1.30	1.30	1.35	1.40	1.45	1.50	1.55	1.55	1.60	1.38
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.34
20-yr gilt yield														
Upside risk	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.33
Arlingclose Central Case	1.85	1.85	1.85	1.85	1.90	1.90	1.95	1.95	2.00	2.05	2.05	2.05	2.10	1.95
Downside risk	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.41
50-yr gilt yield														
Upside risk	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.33
Arlingclose Central Case	1.70	1.70	1.70	1.70	1.75	1.80	1.85	1.90	1.95	1.95	1.95	1.95	2.00	1.84
Downside risk	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.41

Annex B - Existing Investment & Debt Portfolio Position

	31/12/17 Actual Portfolio £m	31/12/17 Average Rate %
External Borrowing:		
PWLB – Fixed Rate	**259.4**	**3.65**
PWLB - Variable	**4.8**	**0.48(tbc)**
Other Local authorities (short term)	**58.0**	**0.43**
LOBO loans from banks	**25.0**	**4.21**
Banks – Fixed Rate (ex Barclays LOBO)	**5.0**	**3.99**
Total External Borrowing	**352.2**	**3.12**
Other Long Term Liabilities:		
PFI	31.0	
Finance Leases	0.7	
Total Gross External Debt	383.9	
Investments:		
Money Market Funds	2.5	0.33
Bank Call Accounts	5.9	0.40
Pooled Funds (CCLA Property Fund)	15.0	4.86(tbc)
Total Investments	23.4	
Net Debt	360.5	
Non-treasury investments:		
Investment property	**45.0**	
Shares in subsidiary	**1.7**	
Loans to subsidiary	**1.7**	**3.13%**
Lease to subsidiary	**7.8**	
Total non-treasury investments	**56.2**	
Total investments	79.6	