Appendix A - Treasury Management Strategy Statement 2019/20 which includes the Borrowing & Investment Strategy, Treasury Management Indicators and Prudential Indicators

A.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested significant 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 financial risk are therefore central to the Council's prudent financial management.

A.2 The Council's treasury management activity is managed in accordance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and the Ministry of Housing Communities & Local Government (MHCLG) guidance.

A.3 This Strategy Statement covers:

a) External & Local Context
b) Borrowing Requirement & Strategy
c) Investment Strategy
d) Treasury Management Indicators
e) Prudential Indicators
f) Other items

External Context

A.4 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements will influence future interest rates and potentially the Council's financial position. It is impossible to predict what this impact will be but the situation will be closely monitored in determining when to borrow funds and for how long.

A.5 The Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rise in the Base Rate in August 2018 to 0.75%. The expectation is that there will be a slow rise in interest rates over the next few years. The Council's Treasury Advisors, Arlingclose, predict the Bank Base Rate will rise twice in 2019 to 1.25%.

A.6 Growth in Gross Domestic Product (GDP) recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average previously achieved. The implications of this are that investment returns are likely to remain relatively low during 2019/20 and beyond.

A.7 The headline rate of UK Consumer Price Inflation fell back to 2.1% year-on-year in December 2018 from 2.3% in November 2018 as cost pressures eased due to a fall in oil prices.

A.8 While external inflationary pressures from energy costs and import prices are expected to subside, domestic pressures are projected to build over the forecast period with the balance of these effects likely to keep inflation above the Bank of England's target, meaning that strong real income growth is unlikely to materialise in the short to medium term.

A.9 As the US economy has continued to perform well, the Federal Reserve maintained its monetary tightening stance and pushed up its target range for the Federal Funds Rate in September 2018 by 0.25% to 2% - 2.25%. One further rise is expected in 2018 and two more in 2019. The Federal Funds rate is an important bench mark, as it is the interest rate at which depository institutions (banks) lend to each other overnight.

A.10 The fallout from the US-China trade dispute continues which, combined with tighter monetary policy risks contributing to a slowdown in global economic activity in 2019. Despite slower growth in the region, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike, currently expected in 2019, and the timing and magnitude of increases thereafter.

A.11 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring-fencing legislation. The ring-fenced banks* now only conduct lower risk retail banking activities and are separate from the investment banks**. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced retail banks generally being better rated than their non-ring-fenced investment banking counterparts.

A.12 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks. Credit ratings will influence borrowing and lending decisions.

*Ringfenced banks are Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank

**Investment banks are Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and Natwest Markets

A.13 **Interest rate forecast:** Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% increases during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast period to 2021. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider that ultra-low interest rates result in other economic problems and that a higher Bank Rate is a more effective way to manage any negative implications on the economy arising from Brexit.

A.14 The UK economic environment remains relatively steady despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly on the downside.

A.15 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected due to the strength of the US economy and the European Central Bank's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon. However volatility arising from both economic and political events is likely to continue to offer borrowing opportunities.

Local Context

A.16 At 31 March 2018, the Authority held £382m external borrowing**. The forecast changes to external borrowing is shown in table 1 below:

Table 1: Balance sheet summary and forecast

	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Forecast £m	31.3.21 Forecast £m	31.3.22 Forecast £m
General Fund CFR	341	458	540	632	687
HRA CFR	186	191	199	226	238
Total CFR	**527**	**649**	**739**	**858**	**925**
Borrowing & PFI liabilities		128	98	129	79
less MRP		(6)	(8)	(10)	(12)
CFR net movement		122	90	119	67
Less: Other debt liabilities *	(27)	(26)	(25)	(24)	(23)
Less: External borrowing **	(382)	(477)	(541)	(635)	(713)
Internal Borrowing	**118**	**146**	**173**	**198**	**189**
Less: Usable reserves	(80)	(90)	(90)	(90)	(90)
Less: Working capital	(25)	(25)	(25)	(25)	(25)
New short term borrowing	**13**	**31**	**58**	**83**	**74**

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

A.17 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 Authority's main objective when borrowing is to strike a balance between securing low interest rates and achieving cost certainty over the period for which funds are required. This position provides short term savings with the flexibility to secure longer dated loans as and when financial forecasts indicate that external borrowing rates may increase.

A.18 The Authority has an increasing CFR due to the Capital Programme, but minimal investments and will therefore be required to borrow up to £235m over the period 2019/20 to 2021/22.

A.19 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2019/20.

Borrowing Strategy

A.20 Historically the Council has borrowed to pay for new assets including schools, roads and community facilities etc. The value of the Council's assets is circa £1bn and includes £470m housing assets. As at 31st December 2018 the Council had £374m of loans outstanding in respect of these assets (both General Fund and HRA).

A.21 The Council has kept borrowing at a similar level to that at the start of the year despite spending additional sums on capital. It has achieved this by reducing the level of short-term investments that were returning a lower rate of interest than that charged on new loans thus minimising the net cost of interest.

A.22 **Objectives:** The Authority's main objective when borrowing money is to strike an appropriately balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

A.23 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates it is likely to be more cost effective in the short-term to either use internal resources or to borrow short-term.

A.24 Market projections indicate that long term borrowing costs will remain relatively low for some time and already take account of anticipated increases in the bank Base Rate. Consequently the Council does not intend to borrow until it needs to thereby avoiding the "cost of carry" (the difference between the cost of borrowing and return on investing the funds until such time as the capital expenditure is incurred).

A.25 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.

A.26 Based on its proposed Capital Programme over the period 2019/20 – 2021/22 the Council has a projected increase in its CFR of £284m.

A.27 The Capital Programme to 31st March 2022, after specific grants, s106 contributions and capital receipts has a borrowing requirement £306m, £260m General Fund and £46m HRA. This is shown in table 1above (£98m + £129m + £79m).

A.28 The majority of General Fund borrowing (£249m) relates to invest to save projects or those that generate a financial return, such as Commercial Investment and Leisure Development. The cost of borrowing together with any associated revenue savings is included within the Council's Medium Term Financial Strategy 2019/20 – 2021/22. The increase in the level of borrowing compared to previous years reflects the lifting of HRA borrowing cap by Government on 30 October 2018 and the Council's Commercial Investment Strategy.

A.29 **Sources of borrowing:** The approved sources of long-term and short-term borrowing 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
- any other UK public sector body
- UK public and private sector pension funds (except Berkshire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

A.30 **Other sources of debt finance:** capital finance may also be raised by the following methods classed as other debt liabilities:

- Leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

A.31 The Authority has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans that may be available at more favourable rates.

A.32 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: 1) borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and 2) there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Council.

A.33 **LOBOs:** The Authority 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 Authority has the option to either accept the new rate or to repay the loan at no additional cost. Although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

A.34 **Short-term and variable rate loans**: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

A.35 **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. In the last quarter up to 31 December 2018 the Authority held on average £374m borrowing at an average rate 3.2%. It 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.

Investment Strategy

A.36 The level of investments fluctuates throughout the year dependant on cash balances. The balance of investments was £56m at the end of December 2018 with an average weighted rate of return of 1.1%. This will earn approximately £500k for the Council that has been assumed in its Treasury Management budget.

A.37 **Objectives:** The CIPFA Code requires the Council to invest its funds prudently and have regard to the security and liquidity of its investments rather than 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 Authority 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.

A.38 **Negative interest rates:** If the UK enters a recession in 2019/20, 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. A situation that already exists in many other European countries. In this event, the security on existing investments will be measured as receiving the contractually agreed amount at maturity.

A.39 **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 into Money Market Funds in 2015/16. We will consider options to further diversify into more secure and/or higher yielding asset classes in 2019/20.

A.40 **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)

A.41 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in Table 2 below, subject to the cash limits and the time limits shown.

<u>Table 2: Approved investment counterparties and limits</u>

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.

A.42 **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.

A.43 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

A.44 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") 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.

Table 3: Counterparties

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

Corporates	Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either 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.
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.
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. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly. At the current time the Council has not used such funds.
Operational bank accounts	The Authority 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 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 Authority maintaining operational continuity.

A.45 **Other information on the security of investments**: The Authority understands that credit ratings are 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, reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality regardless of whether it meets the credit rating criteria.

A.46 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings but can be seen in other market measures. In these circumstances the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office, invested in Government Treasury Bills or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

A.47 **Investment limits:** To avoid putting funds at risk the maximum amount that will be lent to any one organisation (other than the UK Government) will be £20m. 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

A.48 **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 Authority being forced to borrow on unfavourable terms to meet its financial commitments.

Treasury Management Indicators

A.49 The Council measures and manages its exposures to treasury management risks using the following indicators.

A.50 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average 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.

Credit risk indicator	Target
Portfolio average credit score	6.0

A.51 **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 set at £15m

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

A.52 **Interest rate exposures**: This indicator is set to control the Council's exposure to interest rate risk. The 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).

	Actual 31.12.2018	2019/20	2020/21	2021/22
Upper limit on fixed interest rate exposure	93%	110%	110%	110%
Upper limit on variable interest rate exposure	31%	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.

A.53 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	25%	0%
12 months and within 24 months	25%	0%

2 to 5 years	25%	0%
5 to 10 years	25%	0%
10 to 20 years	100%	40%
20 to 30 years	100%	
30 to 40 years	100%	
40 to 50 years	100%	
over 50 years	100%	

This indicator applies to variable rate borrowing, but the Council has minimal variable rate borrowing.

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

A.54 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£25m	£15m	£15m

<u>Other Items</u>

Policy on the use of financial derivatives

A.55 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).

A.56 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 risk 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.

A.57 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Policy on apportioning interest to the HRA

A.58 Reform of the Housing Revenue Account Subsidy system was completed at the end of 2011/12, when we were required to pay MHCLG £147.8m. The Council has adopted a policy tol continue to manage its debt as a single pool using a similar regime to that which applied prior to self-financing.

A.59 During 2016/17 and 2017/18 the methodology was adjusted to recognise that the £147.8m of loans the Council borrowed at the time of self-financing were taken for HRA debt and therefore the operation of the single pool should not lead to the average interest rate charged to the HRA being less than the average rate on the remaining part of those loans.

A.60 Any adjustment of debt outstanding that is required to balance the appropriation in the accounts and above the normal officer delegation will be included in either the mid-year or annual report for approval.

A.61 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 portfolio of treasury investments (excluding the CCLA Property Fund) and short-term borrowing.

Investment training

A.62 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. Staff are also encouraged to study professional qualifications from CIPFA, or other appropriate organisations.

Investment advisers

A.63 The Council has appointed Arlingclose Limited as its treasury management advisers and receives specific advice on investment, debt and capital finance issues. Officers have at least two meetings per annum with Arlingclose and make contact whenever advice is needed on treasury or related matters.

Investment of money borrowed in advance of need

A.64 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.

A.65 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.

Prudential Indicators 2019/20

A.66 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.

A.67 The Prudential Code supports local strategic planning, asset management planning and proper option appraisal.

A.68 To demonstrate that the Council has fulfilled the requirements of the Prudential Code the following indicators must be set and monitored each year.

A.69 **Estimates of Capital Expenditure:** The Council's planned capital expenditure and financing is the key driver of its treasury management activity. A summary for the planned expenditure and financing is shown below. Further detail of the Capital Programme can be found in Appendix 5 of the Medium Term Financial Strategy report which appears elsewhere on the agenda. The revenue consequences associated with borrowing are accommodated within the Council's revenue budgets.

Capital Expenditure and Financing	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
General Fund	158	154	135	78
HRA	19	24	49	25
Total Expenditure	**177**	**178**	**184**	**103**
Grants & Contributions	20	50	35	10
Major Repairs Reserve	10	13	9	10
S106 & CIL	4	3	3	3
Capital Receipts	13	14	7	2
Borrowing	130	98	130	78
Total Financing	**177**	**178**	**184**	**103**

A.70 **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	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
General Fund	458	540	632	687
HRA	191	199	226	238
Total CFR	**649**	**739**	**858**	**925**
Year on year movement	122	90	119	67

The CFR is forecast to rise by £284.3m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment. The amount set aside for Minimum Revenue Provision for debt repayment is assumed to be £21m between 2019/20 and 2021/22.

A.71 **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. Gross debt includes external and internal borrowing.

Debt	31.03.19 Revised £m	31.03.20 Estimate £m	31.03.21 Estimate £m	31.03.22 Estimate £m
Borrowing	477	541	635	713
Finance leases	<1	<1	<1	<1
PFI liabilities	26	25	24	23
Gross Debt	**504**	**567**	**660**	**737**
Total CFR	**649**	**739**	**858**	**923**

As can be seen above, gross debt will remain below the CFR during the forecast period.

A.72 **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) level of external debt it will have to incur during the course of the year. 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. The Operational Boundary is not a limit and actual debt can vary around the boundary on a short term basis.

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	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Borrowing	550	615	710	790
Other long-term liabilities	28	27	26	25
Gross Debt	**578**	**642**	**736**	**815**

A.73 **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	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m	2021/22 Limit £m
Borrowing	620	695	800	890
Other long-term liabilities	40	30	30	30
Gross Debt	**660**	**725**	**830**	**920**

A.74 **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 income,

Ratio of Financing Costs to Net Revenue Stream	2018/19 Revised %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
General Fund	5.0%	8.0%	9.7%	10.7%
HRA	14.8%	13.0%	13.1%	14.5%