

## **Summary Sheet**

### **Council Report**

Cabinet/Commissioners' Decision Making Meeting

#### **Title**

Prudential Indicators and Treasury Management and Investment Strategy 2016/17 – 2018/19

#### **Is this a Key Decision and has it been included on the Forward Plan?**

Yes, included on the Forward Plan for this meeting.

#### **Strategic Director Approving Submission of the Report**

Stuart Booth – (Interim) Strategic Director of Finance & Customer Services

#### **Report Author(s)**

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#### **Ward(s) Affected**

All

#### **Executive Summary**

The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and prepare, set and publish prudential indicators and treasury indicators that ensure the Council's capital expenditure plans and affordable, prudent and sustainable in the long-term.

The Prudential Indicators and Treasury Management Strategy together form part of the process which ensures the Council meets the balanced budget requirement under the Local Government Finance Act 1992.

The report sets out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2016/17 and Prudential Indicators for 2016/17 to 2018/19 and is being presented to Audit Committee in furtherance of its delegated role of scrutiny on Treasury matters, including the Treasury Management Strategy and related policies. The report will be presented to the Advisory Cabinet/Commissioners' Decision Making meeting as part of the Council's 2016/17 Budget setting process.

In accordance with the Prudential Code for Capital Finance, the Secretary of State's Guidance on Local Government Investments, CIPFA's Code of Practice for Treasury Management in Local Authorities and with Council policy, the (Interim) Strategic

Director of Finance & Customer Services is required, prior to the commencement of each financial year to seek the approval of the Council to the following:

- i. The Prudential Indicators and Limits for 2016/17 to 2018/19
- ii. A Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP
- iii. An Annual Treasury Management Strategy in accordance with the CIPFA Code of Practice on Treasury Management including the Authorised Limit
- iv. An Investment Strategy in accordance with the Department for Communities and Local Government (CLG) investment guidance

Albeit a technical and complex report the key messages are:

- a. Investments – the primary governing principle will remain **security** over return and the criteria for selecting counterparties reflect this. Cash available for investment will remain low, resulting in low returns;
- b. Borrowing – overall, this will remain fairly constant over the period covered by this report and the Council will remain under-borrowed against its borrowing requirement due to the higher cost of carrying debt. New borrowing will only be taken up as debt matures; and,
- c. Governance – strategies are reviewed by the Audit Committee with continuous monitoring which includes Mid-Year and Year End reporting.

## **Recommendations**

**Cabinet is asked to recommend to Council that it:**

- i. **Approves the prudential indicators and limits for 2016/17 to 2018/19 contained in the report;**
- ii. **Approves the Minimum Revenue Provision Policy Statement contained in Appendix A which sets out the Council's policy;**
- iii. **Approves the Treasury Management Strategy for 2016/17 to 2018/19 and the Authorised Limit Prudential Indicator; and,**
- iv. **Approves the Investment Strategy for 2016/17 to 2018/19**

## **List of Appendices Included**

Appendix A – Proposed Wording of Minimum Revenue Provision Policy Statement

Appendix B – Borrowing and Investment Projections 2015/16 to 2018/19

Appendix C – Treasury Management Practice (TMP) 1 (5) – Credit and Counterparty Risk Management

Appendix D – Security, Liquidity and Yield Benchmarking

**Background Papers**

CIPFA – The Prudential Code for Capital Finance in Local Authorities

CIPFA – Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes

CIPFA – Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities

Communities and Local Government Investment Guidance – March 2010

The Local Government Act 2003

**Consideration by any other Council Committee, Scrutiny or Advisory Panel**

Yes, Audit Committee prior to submission to this Meeting

**Council Approval Required**

Yes

**Exempt from the Press and Public**

No

## **Prudential Indicators and Treasury Management and Investment Strategy 2016/17 – 2018/19**

### **1. Recommendations**

**Cabinet is asked to recommend to Council that it:**

- i. Approves the prudential indicators and limits for 2016/17 to 2018/19 contained in the report;**
- ii. Approves the Minimum Revenue Provision Policy Statement contained in Appendix A which sets out the Council's policy;**
- iii. Approves the Treasury Management Strategy for 2016/17 to 2018/19 and the Authorised Limit Prudential Indicator; and,**
- iv. Approves the Investment Strategy for 2016/17 to 2018/19**

### **2. Background**

2.1 The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and prepare, set and publish prudential indicators and treasury indicators that ensure the Council's capital expenditure plans and affordable, prudent and sustainable in the long-term.

The prudential indicators consider the affordability and impact of capital expenditure plans, and set out the Council's overall capital framework. Each prudential indicator either summarises the expected activity or introduces limits upon the activity, and reflects the underlying capital programme.

Within the overall prudential framework there is a clear impact on the Council's treasury management activity, either through borrowing or investment activity. As a consequence a Treasury Management Strategy is prepared which considers the effective funding of the capital expenditure decisions and complements the prudential indicators.

2.2 The Prudential Indicators and Treasury Management Strategy together form part of the process which ensures the Council meets the balanced budget requirement under the Local Government Finance Act 1992. It is a statutory requirement under Section 33, revised under Section 31 of the Localism Bill 2011, for the Council to produce a **balanced budget**. In particular, Section 31 requires the Council to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions.

This, therefore, means that increases in capital expenditure must be limited to a level whereby charges to revenue are also limited to a level which is affordable within the projected income of the Council for the foreseeable future. These increased charges arise from:

- increases in interest charges and debt repayment caused by increased borrowing to finance additional to capital expenditure; and
- any increases in running costs from new capital projects

2.3 Treasury management is therefore an important part of the overall financial management of the Council's affairs and is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Specific treasury indicators are prepared and included in the Treasury Management Strategy which requires Member approval.

The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2009). The Council adopted the Code of Practice on Treasury Management (Cabinet, March 2004) and adopted the revisions to the Code in March 2010.

2.4 The Council's constitution (via Financial Regulations) requires the annual Treasury Management Strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. As a minimum a mid-year monitoring report is produced with a further report produced after the year-end to report on actual activity for the year.

Reports on Treasury matters are also required to be adequately scrutinised before being recommended to the Council and this role is undertaken by Audit Committee.

### **3. Key Issues**

#### **3.1 Overview**

The Council's 2015/16 Prudential Indicators and Treasury Management Strategy was approved by Council on 4 March 2015, whilst a Mid-Year report which updated the 2015/16 approved indicators was approved by Council on 27 January 2016. This report provides an update for the period 2015/16 to 2017/18 and introduces new indicators and forecasts for 2018/19.

Section 3.2 of the report details the key elements of the Council's Capital Expenditure Plans and associated Prudential Indicators. The Treasury Management Strategy (including the Investment Strategy) is detailed in Sections 3.3. Supporting detail is provided in the Appendices.

The Treasury Management Strategy has been drawn up in association with the Council's treasury management advisors, Capita Asset Services, part of The Capita Group plc.

This is a technical and complex report however the key messages are:

- Investments – the primary governing principle will remain **security** over return and the criteria for selecting counterparties reflect this. Cash available for investment will remain low, resulting in low returns.
- Borrowing – overall, this will remain fairly constant over the period covered by this report and the Council will remain under-borrowed against the borrowing requirement due to the higher cost of carrying debt. New borrowing will only be taken up as debt matures.
- Governance – strategies are reviewed by the Audit Committee with continuous monitoring which includes the Mid-Year and Year End reporting.

## 3.2 CAPITAL EXPENDITURE PLANS & PRUDENTIAL INDICATORS 2015/16 TO 2017/18

### 3.2.1 The Capital Expenditure Plans

The Council's capital expenditure plans are summarised below and form the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal)
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax and rents)
- Practicality (e.g. the achievability of the forward plan).

The revenue consequences of capital expenditure, particularly the unsupported expenditure, will need to be paid for from the Council's own revenue resources.

This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual expenditure will add to the Council's borrowing need.

3.2.2 The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some of estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For example, anticipated asset sales resulting from the Council's on-going asset rationalisation programme may be deferred due to the on-going impact of the current economic & financial conditions on the property market.

3.2.3 The Cabinet is asked to recommend to Council that it approves the summary capital expenditure projections below which are based on the currently approved Capital Programme 2015/16 to 2017/18 and the schemes (excluding the Development Pool) proposed as part of the new Capital Strategy and detailed Capital Programme.

	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
Children & Young People's Services	11.650	4.726	0.550	0.000
Env & Dev Services	24.924	21.465	16.881	20.737
Neighbourhoods & Adult Services – Non HRA	4.938	5.013	5.180	7.600
Resources	2.782	4.108	1.705	0.562
<b>Total Non-HRA</b>	<b>44.294</b>	<b>35.312</b>	<b>24.316</b>	<b>28.899</b>
HRA	31.732	32.992	33.927	25.900
<b>Total HRA</b>	<b>31.732</b>	<b>32.992</b>	<b>33.927</b>	<b>25.900</b>
<b>Total expenditure</b>	<b>76.026</b>	<b>68.304</b>	<b>58.243</b>	<b>54.799</b>
Capital receipts	3.532	5.746	7.283	3.262
Capital grants, capital contributions & sources other capital funding	52.179	44.691	39.937	32.400
<b>Total financing</b>	<b>55.711</b>	<b>50.437</b>	<b>47.220</b>	<b>35.662</b>
<b>Net financing need for the year</b>	<b>20.315</b>	<b>17.867</b>	<b>11.023</b>	<b>19.137</b>

The above net financing need excludes other long-term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The table therefore indicates the likely additional borrowing that the Council will need to finance from its revenue Budget.

3.2.4 **The Capital Financing Requirement (the Council's Borrowing Need)**

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need (i.e. the cumulative net financing need) and the capital expenditure shown above which has not immediately been paid for increases the CFR.

Following accounting changes the CFR includes any other long term liabilities (OLTL) brought onto the Balance Sheet (e.g. PFI schemes). Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a "borrowing facility" and so the Council is not required to separately borrow for these schemes. It is estimated the Council will have £137.588m within the total CFR at 1 April 2016 in respect of such schemes, primarily the Schools, Leisure and Waste PFI schemes.

The Cabinet will ask Council to approve the CFR projections below:

	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
CFR – General Fund	483.637	498.963	506.801	522.148
CFR – HRA	304.125	304.125	304.125	304.125
<b>Total CFR</b>	<b>787.762</b>	<b>803.088</b>	<b>810.926</b>	<b>826.273</b>
<b>Movement in CFR</b>	<b>6.149</b>	<b>15.326</b>	<b>7.838</b>	<b>15.347</b>
<b>Movement in CFR represented by:</b>				
Net financing need for the year (table at 3.2.3 above)	20.315	17.867	11.023	19.137
Net financing need for the year for OLTL	11.894	-2.154	-2.725	-3.120
<b>Less</b> Minimum Revenue Provision and other financing movements	-26.060	-0.387	-0.460	-0.670
<b>Movement in CFR</b>	<b>6.149</b>	<b>15.326</b>	<b>7.838</b>	<b>15.347</b>

### 3.2.5 Minimum Revenue Provision Policy Statement

3.2.5.1 The Council is required to pay off an element of the accumulated General Fund CFR each year through a revenue charge (the Minimum Revenue Provision - MRP). In addition, it is also allowed to make additional voluntary payments (VRP) where it is prudent to do so. Repayments included in annual PFI charges or finance lease payments are also applied as MRP.

No MRP charge is currently required for the HRA. The HRA charges depreciation on its assets, which is a revenue charge. To alleviate the impact of this charge falling on the tenants, HRA regulations allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years under self-financing (up until 2017/18).

3.2.5.2 CLG Regulations require full Council to approve an MRP Statement in advance of each financial year and detailed rules have been replaced by a single duty to charge an amount of MRP which the Council considers 'prudent'.

The (Interim) Strategic Director of Finance & Customer Services will, where it is prudent to do so, use discretion to review the overall financing of the capital programme and the opportunities afforded by the regulations to maximise the benefit to the Council whilst ensuring it meets its duty to charge a 'prudent' provision. To provide maximum flexibility into the future the recommended MRP policy includes the use of the annuity method in addition to the equal instalments method.

The wording of the proposed MRP Policy Statement requiring Council approval is shown at Appendix A.

### 3.2.6 **Affordability Prudential Indicators**

The previous sections cover those prudential indicators that are used to monitor the impact the capital expenditure plans has on the Council's borrowing position.

Within this framework prudential indicators are used to assess the affordability of the capital expenditure plans. Further indicators are used to provide an indication of the impact the capital expenditure plans has on the overall Council's finances. Cabinet will recommend that the Council be asked to approve the following indicators.

#### 3.2.6.1 **Actual and Estimates of the ratio of financing costs to net revenue stream**

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

The estimates of financing costs include all current commitments, the proposals contained in the proposed 2016/17 Revenue Budget and updated future years' capital expenditure plans.

<b>Ratio of financing costs to Net Revenue Stream</b>				
	<b>2015/16 Revised %</b>	<b>2016/17 Estimated %</b>	<b>2017/18 Estimated %</b>	<b>2018/19 Estimated %</b>
Non-HRA	6.30	6.46	7.36	8.34
HRA	15.94	16.43	16.55	16.56

#### 3.2.6.2 **Estimates of the incremental impact of capital expenditure plans on the Council Tax**

This indicator identifies the revenue costs associated with proposed changes to the capital programme compared to the Council's existing commitments and current plans.

Only schemes in the Council's approved capital programme are included in the indicators and there may be further schemes pending approval. Any additional approvals will normally have to be funded from unsupported borrowing as all identified available resources have been allocated. This would impact on the prudential indicators above.

The impact on Band D Council Tax, as shown in the table below, indicates the impact of the Council's capital expenditure plans as already budgeted for within the proposed Revenue Budget for 2016/17 and the Council's Medium Term Financial Strategy, **and does not indicate additional requirements of Rotherham council tax payers.**

<b>Incremental impact of capital expenditure plans on the Band D Council Tax</b>				
	<b>Revised 2015/16 £</b>	<b>Proposed Budget 2016/17 £</b>	<b>Projection 2017/18 £</b>	<b>Projection 2018/19 £</b>
<b>Council Tax – Band D</b>	12.29	17.06	15.93	17.40

### **3.2.6.3 Estimates of the incremental impact of capital expenditure plans on Housing Rent levels**

Similar to the Council tax calculation, this indicator identifies the revenue cost of proposed changes in the housing capital programme compared to the Council's existing approved commitments and current plans expressed in terms of the impact on weekly rent levels.

<b>Incremental impact of capital expenditure plans on the Housing Rent levels</b>				
	<b>Revised 2015/16 £</b>	<b>Proposed Budget 2016/17 £</b>	<b>Projection 2017/18 £</b>	<b>Projection 2018/19 £</b>
<b>Weekly Housing Rent levels</b>	£0.00	£0.00	£0.00	£0.00

## **3.3 TREASURY MANAGEMENT STRATEGY 2016/17 – 2018/19**

The Treasury Management Strategy covers:

- a. The Council's borrowing and investment projections (para. 3.3.1);
- b. The Council's estimates and limits to borrowing activity (para. 3.3.2 to 3.3.5);
- c. The expected movement in interest rates (para. 3.3.6);
- d. The Council's borrowing and debt strategy (para. 3.3.7);
- e. The Council's investment strategy (para. 3.3.8);
- f. Treasury Management prudential indicators and limits on activity (para. 3.3.9);
- g. Treasury performance indicators (para. 3.3.10); and
- h. Policy on the use of external service advisers (para. 3.3.11).

### 3.3.1 Borrowing and Investment Projections 2016/17 – 2018/19

The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed.

The effect on the treasury position over the next three years for both the Council and the ex-SYCC debt that the Council administers on behalf of the other South Yorkshire authorities is shown in the table attached at Appendix B. The table also highlights the expected level of investment balances.

### 3.3.2 Limits to Borrowing Activity

There are a number of key indicators to ensure the Council operates its activities within well-defined limits.

For the first of these, the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years (para. 3.3.4).

The (Interim) Strategic Director of Finance & Customer Services reports that the Council has complied with this indicator in the current year and does not envisage difficulties for the future (the table below refers). This view takes into account approved commitments and existing plans.

RMBC	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
Borrowing (loans outstanding)	481.017	490.805	553.233	593.484
Borrowing included within OLTL	137.588	135.434	132.709	129.589
<b>Total Borrowing</b>	<b>618.605</b>	<b>626.239</b>	<b>685.942</b>	<b>723.073</b>
Less: Investments	20.000	20.000	50.000	80.000
<b>Net Borrowing</b>	<b>598.605</b>	<b>606.239</b>	<b>635.942</b>	<b>643.073</b>
CFR – excl. OLTL	650.174	667.654	678.217	696.684
CFR – OLTL	137.588	135.434	132.709	129.589
<b>Total CFR</b>	<b>787.762</b>	<b>803.088</b>	<b>810.926</b>	<b>826.273</b>
<b>CFR less Net Borrowing</b>	<b>189.157</b>	<b>196.849</b>	<b>174.984</b>	<b>183.200</b>

### 3.3.3 The Overall Level of Borrowing

A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- The Authorised Limit for External Debt
- The Operational Boundary for External Debt

### 3.3.3.1 The Authorised Limit for External Debt

This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all council's plans, or those of a specific council, although no such Government control has yet been exercised.

Cabinet is asked to recommend to Council the approval of the following Authorised Limit for RMBC:

Authorised Limit for External Debt (RMBC)	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
Borrowing	683.381	698.201	702.315	701.855
Other long term liabilities	139.267	137.588	135.434	132.709
Total	822.648	835.789	837.749	834.564

Cabinet is also asked to recommend approval to Council of the following Authorised Limit for the former SYCC:

Authorised Limit for External Debt (Former SYCC)	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
Borrowing	96.121	86.709	76.709	37.000
Other long term liabilities	0.000	0.000	0.000	0.000
Total	96.121	86.709	76.709	37.000

3.3.3.2 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit remains unchanged until there is any change in Government legislation. Interest calculated with reference to the HRA CFR is charged on a fair & equitable basis.

HRA Debt Limit	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
HRA Debt Cap	336.623	336.623	336.623	336.623
HRA CFR	304.125	304.125	304.125	304.125
HRA Headroom (+)	+32.498	+32.498	+32.498	+32.498

### 3.3.3.3 The Operational Boundary for External Debt

This is the amount beyond which external borrowing is not normally expected to exceed. In most cases this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing.

As a result of the planned continued under-borrowed position Cabinet is asked to recommend to Council that it approves the following Operational Boundary for RMBC:

<b>Operational Boundary for External Debt (RMBC)</b>	<b>2015/16 Revised £m</b>	<b>2016/17 Estimated £m</b>	<b>2017/18 Estimated £m</b>	<b>2018/19 Estimated £m</b>
Borrowing	481.017	490.805	553.233	593.484
Other long term liabilities	139.267	137.588	135.434	132.709
<b>Total</b>	<b>620.284</b>	<b>628.393</b>	<b>688.667</b>	<b>726.193</b>

Cabinet is asked to recommend to Council that it approves the following Operational Boundary for the former SYCC:

<b>Operational Boundary for External Debt (Former SYCC)</b>	<b>2015/16 Revised £m</b>	<b>2016/17 Estimated £m</b>	<b>2017/18 Estimated £m</b>	<b>2018/19 Estimated £m</b>
Borrowing	96.121	86.709	76.709	37.000
Other long term liabilities	0.000	0.000	0.000	0.000
<b>Total</b>	<b>96.121</b>	<b>86.709</b>	<b>76.709</b>	<b>37.000</b>

### **3.3.4 Policy on Borrowing in Advance of Need**

The Council has some flexibility to borrow funds in advance for use in future years. The (Interim) Strategic Director of Finance & Customer Services may do this under delegated powers where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or help meet budgetary constraints.

Whilst the (Interim) Strategic Director of Finance & Customer Services will adopt a prudent approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund debt maturities.

Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year and annual reporting mechanism.

### **3.3.5 Debt Rescheduling**

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. These savings will need to be considered in the light of the current treasury position and the value of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings;
- Helping to fulfil the treasury strategy; and,
- Enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

### 3.3.6 **Expected Movement in Interest Rates**

The Bank Rate, currently 0.50%, underpins investment returns and is not expected to start increasing until the fourth quarter of 2016. This is despite inflation remaining below the Monetary Policy Committee inflation target of 2% and unemployment falling below the 7% at which point the Bank of England had indicated it may consider increasing the rate.

Due to on-going issues in areas of the world economy, most notably China, the Eurozone, and falling commodity prices there is continuing uncertainty in the financial markets. As a result, the outlook for borrowing rates also continues to be uncertain and difficult to predict. Short-term rates to one-year are expected to remain at current levels. The outlook for long-term interest rates continues to be favourable in the near future, but is expected to become less so towards the end of the next or early in the following financial year.

This challenging outlook has several key treasury management implications:

- Investment returns are likely to remain relatively low during 2016/17;
- Borrowing interest rates are currently attractive but are less likely to remain so going forward. The Council has adopted a policy of delaying new borrowing by utilising spare cash balances over the last few years. This approach needs to be carefully reviewed to avoid incurring higher borrowing costs in future, when the Council will not be able to delay new borrowing to finance new capital expenditure and/or to refinance maturing debt. The timing of any borrowing will therefore be monitored carefully; and
- There will remain a cost of carrying capital – any borrowing undertaken that results in an increase in investments will incur an incremental cost as the cost of borrowing is greater than the likely investment return.

### 3.3.7 **Borrowing and Debt Strategy 2016/17 – 2018/19**

The Council is currently maintaining an under-borrowed position. This means that the CFR has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk remains relatively high.

The uncertainty over future interest rates increases the inherent risks associated with treasury activity. As a result the Council will continue to take a prudent approach to its treasury strategy.

The (Interim) Strategic Director of Finance & Customer Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely shorter term fixed rates may provide lower cost opportunities in the short to medium term.

### 3.3.8 Investment Strategy 2016/17 – 2018/19

The primary objectives of the Council's investment strategy are:

- Firstly to safeguard the timely repayment of principal and interest (security);
- Secondly to ensure adequate liquidity; and
- Thirdly to produce an investment return (yield).

3.3.8.1 As part of this Strategy, Members need to consider and approve security and liquidity benchmarks in addition to yield benchmarks which are currently widely used to assess investment performance and have previously been reported to Members. The proposed benchmarks are set down in Appendix D.

3.3.8.2 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections of Appendix C.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested as set out in Appendix D.

3.3.8.3 The (Interim) Strategic Director of Finance & Customer Services will maintain a counterparty list in compliance with the criteria set out in 3.3.8.5 and will revise the criteria and submit them to Council for approval as necessary. These criteria are different to those which are used to select Specified and Non-Specified investments.

The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

3.3.8.4 Credit rating information is supplied by our treasury advisors on all active counterparties that comply with the criteria in section 3.3.8.5. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change) and rating outlooks (notification of a possible long term change) are provided to officers almost immediately after they occur and this information is considered before any investment decision is taken.

3.3.8.5 The criteria for providing a portfolio of high quality investment counterparties (both Specified and Non-Specified investments) are:

- **Banks** – The Council will use banks which are rated by at least two rating agencies and have at least the following Fitch, Moody's and Standard and Poor's ratings (where rated):

	Fitch	Moody's	Standards & Poor's
Short-term	F1	P-1	A-1
Long-term	A-	A3	A-

To allow for the day to day management of the Council's cash flow the Council's bankers will also be retained on the list of counterparties if ratings fall below the above minimum criteria.

- **Building Societies** – the Council will use the top 20 Building Societies ranked by asset size but restricted to a maximum of 20% of the investment portfolio
- **Money Market Funds** – AAA – restricted to a maximum of 20% of the investment portfolio
- **UK Government** – Debt Management Office
- **UK Single Tier & County Councils** – (i.e. Metropolitan Districts, London Boroughs, County Councils, Unitary Authorities)

A limit of 35% will be applied to the use of Non-Specified investments within the investment portfolio, excluding day to day cash management through the Council's own bank.

Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market and sovereign information will continue to be applied before making any specific investment decision from the agreed portfolio of counterparties.

3.3.8.6 The time and monetary limits for institutions on the Council's Counterparty List are as follows and represent no change from those currently approved (these will cover both Specified and Non-Specified Investments):

	Fitch	Moody's	Standard & Poor's	Money Limit	Time Limit
Upper Limit Category	F1+/AA-	P-1/Aa3	A-1+/AA-	£20m	5 years
Middle Limit Category	F1/A-	P-1/A3	A-1/A-	£10m	364 days
Lower Limit Category *	All Building Soc's ranked 1 to 10 All Building Soc's ranked 11 to 20			£5m £1m	6 mths 3 mths
Debt Management Office	-	-	-	Unlimited **	6 months
Money Market Funds ***	-	-	-	£20m	n/a
UK Single Tier & County Councils	-	-	-	£20m	5 years
Council's Bankers	-	-	-	£10m	364 days
The above money limits are exclusive of bank balances held by schools					
* Based on maximum of 20% of the investment portfolio					
** Provides maximum flexibility					
*** Based on maximum of 20% of the investment portfolio					

3.3.8.7 The proposed criteria for Specified and Non-Specified investments and monitoring of counterparties are shown in Appendix C for Member approval.

In the normal course of the Council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the long term investment limits.

### 3.3.9 Treasury Management Prudential Indicators and Limits on Activity

3.3.9.1 There are four further treasury activity limits the purpose of which are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs. The limits are:

- Upper limits on fixed interest rate exposure – This identifies a maximum limit for fixed interest rates based upon the fixed debt position net of fixed interest rate investments.

- Upper limits on variable interest rate exposure – as above this limit covers a maximum limit on variable interest rates based upon the variable debt position net of variable interest rate investments.
- Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- Total funds invested for greater than 364 days – These limits are set to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

For the purposes of these indicators the Council's market debt with Financial Institutions is treated as variable where debt may be subject to variation on specific call dates each year. However, over this Strategy period any such variations are thought unlikely.

3.3.9.2 The activity limits (prudential indicators) for Member approval are as follows:

RMBC	2016/17	2017/18	2018/19
<b>Interest rate Exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rate debt based on fixed net debt</b>	100%	100%	100%
<b>Limits on variable interest rate debt based on variable net debt</b>	30%	30%	30%

RMBC Maturity Structure of fixed interest rate borrowing 2016/17	Lower	Upper
Under 12 months	0%	35%
12 months to 2 years	0%	35%
2 years to 5 years	0%	40%
5 years to 10 years	0%	40%
10 years to 20 years	0%	45%
20 years to 30 years	0%	50%
30 years to 40 years	0%	50%
40 years to 50 years	0%	55%
50 years and above	0%	60%

RMBC Maximum Funds invested > 364 days	1 to 2 years	2 to 3 years	3 to 5 years
Funds invested > 364 days	£m 10	£m 8	£m 6

Former SYCC	2016/17	2017/18	2018/19
<b>Interest Rate Exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on total debt</b>	100%	100%	100%
<b>Limits on variable interest rates based on total debt</b>	30%	30%	30%

Former SYCC Maturity Structure of fixed interest rate borrowing 2016/17	Lower	Upper
Under 12 months	0%	25%
12 months to 2 years	0%	50%
2 years to 5 years	0%	100%

### 3.3.10 Treasury Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The results of the following two indicators will be reported in the Treasury Annual Report for 2016/17:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Investments – Internal returns above the 7 day London Interbank Bid rate (LIBID) which is the rate at which a bank is willing to borrow from other banks

### 3.3.11 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. Training has recently been undertaken by Members of the Audit Committee and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

### 3.3.12 Policy on the use of external service advisors

The Council uses Capita Asset Services a subsidiary of The Capita Group plc as its treasury management advisors.

The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;

- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and,
- Credit rating/market information service comprising the three main credit rating agencies.

Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the Council recognises that responsibility for treasury management decisions remains with the Council at all times. The service is provided to the Council under a contractual agreement which is subject to regular review.

#### **4. Options considered and recommended proposal**

4.1 The recommendations have been put forward taking account of the proposed capital programme, the prevailing conditions in the financial markets and expectations for the future with regard to the economic outlook and the effect on interest rate, together with the actions required to manage risk in the Treasury Management activity for the forthcoming financial year.

#### **5. Consultation**

5.1 Consultation has taken place with the Council's Treasury Management Advisers, Capita plc

5.2 Consultation with the Council's External Auditors KPMG has taken place with respect to the wording of the Council's Minimum Revenue Provision Policy Statement.

#### **6. Timetable and Accountability for Implementing this Decision**

6.1 Following consideration by Audit Committee the report is being presented to this meeting and then in accordance with the legislative requirements outlined in section 8 below the report will be submitted to full Council on 2<sup>nd</sup> March 2016.

#### **7. Financial and Procurement Implications**

7.1 Treasury Management forms an integral part of the Council's overall financial arrangements.

- 7.2 The assumptions supporting the capital financing budget for 2016/17 and for the future years covered by the MTFS of the Council have been reviewed in light of the current economic and financial conditions and the revised future years' capital programme.
- 7.3 The proposed Treasury Management and Investment Strategy is not forecasted to have any further revenue consequences other than those identified and planned for in both the Council's 2016/17 Revenue Budget and approved MTFS.

## **8. Legal Implications**

- 8.1 It is a requirement that changes to the Council's prudential indicators and approved by Full Council
- 8.2 It is also a requirement that the Council's Minimum Revenue Provision Policy Statement for each financial year is approved by Full Council.

## **9. Human Resources Implications**

- 9.1 There are no Human Resource implications arising from the report.

## **10. Implications for Children and Young People and Vulnerable Adults**

- 10.1 There are no implications arising from the proposals to Children and Young People and Vulnerable Adults.

## **11. Equalities and Human Rights Implications**

- 11.1 There are no implications arising from this report to Equalities and Human Rights.

## **12. Implications for Partners and Other Directorates**

- 12.1 There are no implications arising from this report to Partners or other directorates.

## **13. Risks and Mitigation**

- 13.1 The proposed Treasury Management and Investment Strategy seeks to minimise the risks inherent in operating a Treasury Management function during these difficult economic and financial conditions.

Operational Treasury Management guidelines will continue to be kept in place and reviewed to ensure they are appropriate given the circumstances faced, supported by regular monitoring to ensure that any risks and uncertainties are addressed at an early stage and hence kept to a minimum.

**14. Accountable Officer(s)**

Stuart Booth ((Interim) Strategic Director of Finance & Customer Services)

Approvals Obtained from:-

(Interim) Strategic Director of Finance & Customer Services:- Stuart Booth

(Interim) Assistant Director of Legal Services:- Catherine Parkinson

This report is published on the Council's website or can be found at:-

<http://moderngov.rotherham.gov.uk/ieDocHome.aspx?Categories=>

**Proposed Wording of Minimum Revenue Provision Policy Statement**

It is being recommended Council approve the following MRP policy in relation to the charge for the 2016/17 financial year:

- (a) The MRP charge in relation to capital expenditure incurred prior to 2007/08 where the expenditure was funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset and the calculation of the provision will be by the annuity method;
- (b) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset at the point the asset is brought into use. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate; and
- (c) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by a 'capitalisation directive' (e.g. equal pay) will be calculated on the basis of the specified period(s) set down within the regulations. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate.
- (d) For the sake of clarity, where MRP has been overcharged in previous years, the recovery of the overcharge will be effected by taking an MRP holiday in full or in part against future years charges that would otherwise have been made. The MRP holiday adjustment to the future years charge will be done in such a way as to ensure that:
  - the total MRP after applying the adjustment will not be less than zero in any financial year
  - the cumulative amount adjusted for will never exceed the amount overcharged;
  - the extent of the adjustment will be reviewed on an annual basis

## Appendix B

### Borrowing and Investment Projections 2015/16 to 2018/19

RMBC	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
<b>External Debt</b>				
Borrowing at 1 April	468.884	481.017	490.805	553.233
Expected change in debt	12.133	9.788	62.428	40.251
Borrowing at 31 March	481.017	490.805	553.233	593.484
Other long-term liabilities (OLTL) at 1 April	125.694	137.588	135.434	132.709
Expected change in OLTL	11.894	-2.154	-2.725	-3.120
Other long-term liabilities (OLTL) at 31 March	137.588	135.434	132.709	129.589
Total Borrowing & OLTL at 31 March	618.605	626.239	685.942	723.073
<b>Investments</b>				
Total Investments at 1 April	18.674	20.000	20.000	50.000
Investment change	1.326	0.000	30.000	30.000
Total Investments at 31 March	20.000	20.000	50.000	80.000
Net borrowing at 31 March	598.605	606.239	635.942	643.073

Ex SYCC	2015/16 Revised £m	2016/17 Estimated £m	2017/18 Estimated £m	2018/19 Estimated £m
<b>External Debt</b>				
Borrowing at 1 April	96.121	86.709	76.709	37.000
Expected change in debt	-9.412	-10.000	-39.709	-0.811
Borrowing at 31 March	86.709	76.709	37.000	36.189
<b>Investments</b>				
Total Investments at 1 April	0.000	0.000	0.000	0.000
Investment change	0.000	0.000	0.000	0.000
Total Investments 31 March	0.000	0.000	0.000	0.000
Net borrowing at 31 March	86.709	76.709	37.000	36.189

**Treasury Management Practice (TMP) 1 (5) – Credit and Counterparty Risk Management**

**1. Overview**

1.1 The Office of the Deputy Prime Minister (now CLG) issued Revised Investment Guidance in March 2010, and this forms the structure of the Council's policy below.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield.

1.2 In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council has adopted the Code will apply its principles to all investment activity.

In accordance with the Code, the (Interim) Strategic Director of Finance & Customer Services has reviewed and prepared its treasury management practices. This part, TMP 1(5), covering investment counterparty policy requires approval each year.

**2. Annual Investment Strategy**

2.1 The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The guidelines for investment decision making, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which investments can be made.
- The specified investments the Council may use.
- The non-specified investments the Council may use.

This strategy is to be approved by full Council.

The investment policy proposed for the Council is detailed in the paragraphs below.

**2.2 Strategy Guidelines**

The main strategy guidelines are contained in the body of the treasury strategy statement.

## **2.3 Specified Investments**

2.3.1 These investments are sterling investments of not more than one-year maturity. If they are for a longer period then the Council must have the right to be repaid within 12 months if it wishes.

These are low risk assets where the possibility of loss of principal or investment income is small.

2.3.2 These would include the following investment categories:

1. The UK Government Debt Management Office.
2. UK Single Tier & County Councils – (i.e. Metropolitans District, London Boroughs, County Councils, Unitary Authorities)
3. Money Market Funds that have been awarded AAA credit ratings by Standard and Poor's, Moody's or Fitch rating agencies and restricted to 20% of the overall investment portfolio
4. A bank or a building society that has been awarded a minimum short-term rating of F1 by Fitch, P-1 by Moody's and A-1 by Standard and Poor's rating agencies. For Building Societies investments will be restricted to 20% of the overall investment portfolio and:
  - a maximum of £5m for a period not exceeding 6 months if the society is ranked in the top 10 by asset size; or
  - a maximum of £1m and a period not exceeding 3 months if the society is ranked 11 to 20 by asset size.

## **2.4 Non-Specified Investments**

2.4.1 Non-specified investments are any other type of investment not defined as specified above.

The criteria supporting the selection of these investments and the maximum limits to be applied are set out below.

2.4.2 Non specified investments would include any sterling investments with:

1. A bank that has been awarded a minimum long term credit rating of AA- by Fitch, Aa3 by Moody's and AA- by Standard & Poor's for deposits with a maturity of greater than 1 year.
2. The Council's own bank if ratings fall below the above minimum criteria.

3. A Building Society which is ranked in the top 20 by asset size. Investments will be restricted to 20% of the overall investment portfolio and:

- a maximum of £5m for a period not exceeding 6 months if the Society is ranked in the top 10 by asset size; or
- a maximum of £1m and a period not exceeding 3 months if the Society is ranked 11 to 20 by asset size.

### **3 The Monitoring of Investment Counterparties**

3.1 The credit rating of counterparties will be monitored regularly. The Council receives credit rating information from the Council Treasury Management advisors on a daily basis, as and when ratings change, and counterparties are checked promptly.

On occasions ratings may be downgraded after the date on which an investment has been made. It would be expected that a minor downgrading would not affect the full receipt of the principal and interest.

3.2 Any counterparty failing to meet the minimum criteria will be removed from the list immediately by the (Interim) Strategic Director of Finance & Customer Services, and new counterparties will be added to the list if and when they meet the minimum criteria.

## **Security, Liquidity and Yield Benchmarking**

These benchmarks are targets and so may be exceeded from time to time with any variation reported, with supporting reasons in Mid-Year & Annual Treasury Reports.

### **1. Security and liquidity**

These benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators, e.g. the maximum funds which may be invested for more than 364 days, the limit on the use of Non-specified investments, etc.

#### **1.1 Security**

- 1.1.1 Security is currently evidenced by the application of minimum criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies. Whilst this approach embodies security considerations, benchmarking the levels of risk is more subjective and therefore problematic.
- 1.1.2 One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy.

<b>Credit Rating</b>	<b>1 year</b>	<b>2 years</b>	<b>3 years</b>	<b>4 years</b>	<b>5 years</b>
<b>AAA</b>	0.04%	0.09%	0.17%	0.25%	0.34%
<b>AA</b>	0.03%	0.06%	0.11%	0.22%	0.33%
<b>A</b>	0.08%	0.20%	0.37%	0.55%	0.77%
<b>BBB</b>	0.19%	0.55%	0.97%	1.46%	1.97%

- 1.1.3 The Council's minimum long term rating criteria (over one year) is "AAA" meaning the average expectation of default for a three year investment in a counterparty with a "AAA" long term rating would be 0.17% of the total investment (e.g. for a £1m investment the average potential loss would be £1,700).

The Council's minimum long term rating criteria (up to one year) is "BBB" and the average expectation of default for such an investment would be 0.19% (e.g. for a £1m investment the average loss would be £1,900).

These are only averages but do act as a benchmark for risk across the investment portfolio.

**The Council's maximum security risk benchmark for the estimated maximum portfolio during 2016/17 is 0.096% which means that for every £1m invested the average potential loss would be £960. This position remains largely unchanged from 2015/16.**

- 1.1.4 The Council's Treasury advisers maintain a continuous review of the risk position by the inclusion the Council's daily investment position within their online model.

## 1.2 **Liquidity**

1.2.1 This is defined as “having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable the Council at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives” (CIPFA Treasury Management Code of Practice). The Council seeks to maintain:

- Bank overdraft – on a day-to-day basis the Council works to an agreed overdraft limit of £100,000 with the Council’s bankers. Whilst a short-term increase could be negotiated less expensive short-term borrowing is accessed through the financial markets to remain within the agreed overdraft.
- Liquid, short term deposits of at least £3m available with a week’s notice.

1.2.2 The availability of liquidity and the inherent risks arising from the investment periods within the portfolio is monitored using the Weighted Average Life (WAL) of the portfolio. This measures the time period over which half the investment portfolio would have matured and become liquid

A shorter WAL generally represents less risk and in this respect the benchmark to be used for 2016/17 is:

- 0.08 years which means that at any point in time half the investment portfolio would be available within 28 days.

## 2. **Yield**

These benchmarks are currently widely used to assess investment performance and the Council’s local measure of yield is:

- Internal returns above the 7 day London Interbank Bid rate (LIBID) which is the rate at which a bank is willing to borrow from other banks