REPORT TO:	Executive Board
DATE:	11 February 2016
REPORTING OFFICER:	Operational Director – Finance
PORTFOLIO:	Resources
TITLE:	Treasury Management Strategy Statement 2016/17
WARDS:	Borough-wide

1.0 PURPOSE OF REPORT

1.1 To consider the Treasury Management Strategy Statement which incorporates the Annual Investment Strategy (AIS) and the Minimum Revenue Provision (MRP) Strategy for 2016/17.

2.0 RECOMMENDATION: That Council be recommended to adopt the policies, strategies, statements, prudential and treasury indicators outlined in the report.

3.0 SUPPORTING INFORMATION

3.1 This Treasury Management Strategy Statement (TMSS) details the expected activities of the treasury function in the forthcoming financial year (2016/17). Its production and submission to Council is a requirement of the CIPFA Code of Practice on Treasury Management.

3.2 The Local Government Act 2003 requires the Council to ‘have regard to’ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

3.3 The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.4 Government guidance notes state that authorities can combine the Treasury Strategy Statement and Annual Investment Strategy into one report. The Council has adopted this approach and the Annual Investment Strategy is therefore included as section 4.

3.5 The Council is also required to produce a Minimum Revenue Provision (MRP) Policy Statement. There is a formal statement for approval detailed in paragraph 2.3, Appendix A shows the full policy, and the changes in the policy for 2016/17 are detailed in Appendix B.

4.0 POLICY IMPLICATIONS

4.1 The successful delivery of the strategy will assist the Council in meeting its budget commitments.

5.0 OTHER IMPLICATIONS

5.1 None.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 There are no direct implications, however, the revenue budget and capital programme support the delivery and achievement of all the Council's priorities.

7.0 RISK ANALYSIS

7.1 The Authority operates its treasury management activity within the approved code of practice and supporting documents. The aim at all times is to operate in an environment where risk is clearly identified and managed. This strategy sets out clear objectives within these guidelines.

7.2 Regular monitoring is undertaken during the year and reported on a half-yearly basis to the Executive Board.

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 None.

9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

Document	**Place of Inspection**	**Contact Officer**
Working Papers	Financial Management	Matt Guest
CIPFA TM Code	Kingsway House	
CIPFA Prudential Code		

HALTON BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY STATEMENT

2016/17

Financial Management Division
Finance Department
December 2015

TREASURY MANAGEMENT STRATEGY STATEMENT 2016/17

1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management 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."

1.2 Reporting requirements

The Council is required to receive and approve the following reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - which covers:

- The capital plans (including prudential indicators)
- A minimum revenue provision (MRP) policy - how residual capital expenditure is charged to revenue over time
- The treasury management strategy – how the investment and borrowing are organised, including treasury indicators
- An investment strategy – the parameters of how investments are to be managed

A mid-year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Executive Board.

1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues
- the capital plans and the prudential indicators
- the minimum revenue provision (MRP) policy

Treasury Management Issues
- The current treasury position
- Treasury indicators which limit the treasury risk and activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling
- The investment strategy
- Creditworthiness policy
- Policy on use of external service providers

These elements cover the requirement of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 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 was undertaken by members in October 2013 and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The table below summarises how these plans are being financed by capital or revenue resources, any shortfall of resources results in the need to borrow.

Table 1 – Capital Expenditure

	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Capital Expenditure:					
Children & Enterprise	8,095	-	-	-	-
Policy & Resources	19,598	-	-	-	-
Communities	4,464	-	-	-	-
People & Economy	-	26,288	9,522	1,327	300
Community & Resources	-	21,700	95,624	55,659	6,616
Slippage Adjustment	-	(9,598)	2,569	2,132	3,515
	32,157	**38,390**	**107,715**	**59,118**	**10,431**
Financed By:					
Capital receipts	(5,408)	(5,996)	(7,378)	(3,429)	(1,992)
Capital grants	(21,457)	(17,095)	(12,173)	(5,625)	(3,733)
Revenue	(1,505)	(1,370)	(551)	(69)	-
Net financing need for the year	**3,787**	**13,929**	**87,613**	**49,995**	**4,706**

The above financing need excludes other long term liabilities such as PFI and leasing arrangements which already include borrowing instruments.

2.2 The Council's borrowing need – The Capital Financing Requirement

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic 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. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with the life of each asset.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase 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. An estimate of £100k has been used for finance leases in future years.

Table 2 – Capital Financing Requirement

	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Capital Financing Requirement	**106,807**	**107,893**	**119,889**	**205,215**	**252,907**
Movement in CFR due to:					
Net financing need for the year	3,787	13,929	87,613	49,995	4,706
PFI / Finance Leases	224	100	100	100	100
Less Minimum Revenue Provision	(2,925)	(2,033)	(2,387)	(2,403)	(2,407)
Increase / (Decrease) in CFR	**1,086**	**11,996**	**85,326**	**47,692**	**2,399**

2.3 Minimum revenue provision (MRP) statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge called the Minimum Revenue Provision (MRP).

CLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The full statement is detailed in Appendix A and the changes to the 2016/17 MRP statement are detailed in Appendix B.

The Council is recommended to approve the following MRP Statement.

For capital expenditure incurred before 1 April 2008 the MRP policy will be to follow Option 1 (regulatory method), but from 2016/17 will be charged at 2% straight line (this was previously charged at 4% reducing balance).

For all unsupported borrowing since 1 April 2008, the MRP policy will be Option 3 (Asset Life Method) and is based on the estimated life of the assets. This will usually be charged using the equal instalment method, but the annuity method may also be used.

The MRP relating to PFI schemes and finance leases will be based on the annual lease payment, and will have no direct impact on the Council's revenue budget.

2.4 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

2.5 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing net of investment income) against the net revenue stream.

Table 3 – Ratio of financing costs to net revenue stream

Ratio of Finance Costs to Net Revenue Stream	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Council's Net Budget	**108,243**	**101,452**	**98,465**	**91,867**	**88,836**
Finance Costs					
Net Interest Costs	1,019	1,120	733	370	162
Minimum Revenue Provision	2,201	2,128	1,407	1,941	1,941
	3,220	**3,248**	**2,140**	**2,311**	**2,103**
	3.0%	**3.2%**	**2.2%**	**2.5%**	**2.4%**

Interest costs relating to the Mersey Gateway project and have been excluded from the above estimates as these will not be a cost on the Council's revenue budget. The MRP and Interest cost relating to PFI schemes and finance leases do not add any additional cost to the revenue budget, so have also been excluded.

2.6 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. For this table it has been assumed that the tax base will remain the same for the following three years.

Table 4 – Impact of capital investment decisions on Council Tax

Incremental Impact of capital investment decisions on band D Council Tax	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Net cost of additional borrowing	353	315	87	187	140
Council Tax Base	31,400	32,948	32,948	32,948	32,948
Impact on Band D (£)	**11.23**	**9.56**	**2.63**	**5.66**	**4.26**

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 5 – External Debt

External Debt	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Borrowing					
Debt at 1 April	70,000	183,000	163,000	143,000	153,000
Expected Change in Debt	113,000	(20,000)	(20,000)	10,000	-
Debt at 31 March	**183,000**	**163,000**	**143,000**	**153,000**	**153,000**
Other long-term liabilities					
Debt at 1 April	23,282	22,549	21,852	21,326	20,980
Expected Change in Debt	(733)	(697)	(526)	(346)	(954)
Debt at 31 March	**22,549**	**21,852**	**21,326**	**20,980**	**20,026**
Total External Debt at 31 March	**205,549**	**184,852**	**164,326**	**173,980**	**173,026**
Capital Financing Requreiment	**107,893**	**119,889**	**205,215**	**252,907**	**255,306**
Under / (over) borrowing	**(97,656)**	**(64,963)**	**40,889**	**78,927**	**82,280**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt 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, but ensures that borrowing is not undertaken for revenue purposes.

The table above shows that the Council are expecting to be in an overborrowed position for 2015/16. This is relating to the borrowing in advance of need that was done in respect to the Mersey Gateway project. Further detail is given in 3.5.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary

This is the limit beyond which external debt 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 debt.

Table 6 – Operational Boundary

Operational boundary	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Debt	233,100	233,100	233,100	233,100
Other Long Term Liabilities	19,500	21,826	21,480	20,526
Total	**252,600**	**254,926**	**254,580**	**253,626**
Total External Debt at 31 March	184,852	164,326	173,980	173,026
Estimated Headroom	**67,748**	**90,600**	**80,600**	**80,600**

The boundary is significantly higher than the CFR until 2017/18. This is due to borrowing in advance of need for the Mersey Gateway.

The authorised limit for external debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited. 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 councils' plans, or those of a specific council, although this power has not yet been exercised.

Table 7 – Authorised Limit

Authorised limit	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Debt	250,000	250,000	250,000	250,000
Other Long Term Liabilities	20,000	20,000	20,000	20,000
Total	**270,000**	**270,000**	**270,000**	**270,000**
Total External Debt at 31 March	184,852	164,326	173,980	173,026
Estimated Headroom	**85,148**	**105,674**	**96,020**	**96,974**

3.3 Prospects for Interest Rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table and commentary is the view of Capital Asset Services:

Table 8 – Interest rate forecast

Quarter Average	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Mar-16	0.50	2.4	3.0	3.7	3.5
Jun-16	0.75	2.6	3.1	3.8	3.7
Sep-16	0.75	2.7	3.2	3.9	3.8
Dec-16	1.00	2.8	3.3	4.0	3.9
Mar-17	1.00	2.8	3.4	4.1	4.0
Jun-17	1.25	2.9	3.5	4.1	4.0
Sep-17	1.50	3.0	3.5	4.2	4.1
Dec-17	1.50	3.2	3.7	4.3	4.2
Mar-18	1.75	3.3	3.8	4.3	4.2
Jun-18	1.75	3.4	3.9	4.4	4.3
Sep-18	2.00	3.5	4.0	4.4	4.3
Dec-18	2.00	3.5	4.1	4.4	4.3
Mar-19	2.00	3.6	4.1	4.5	4.4

Overview

The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years. This is driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee will decide to make a start on increasing Bank Rate.

The American economy made a strong comeback after a weak first quarter to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 1.5% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the non-farm payroll figure for growth in employment in October was very strong and, together with a likely perception by the Federal Reserve that concerns on the international scene have subsided, has now firmly opened up the possibility of a first rate rise in December.

In the Eurozone (EZ), the European Central Bank (ECB) fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its Quantative Easing programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Greek Government, elected in January, to EU demands. The surprise general election in September gave the Greek government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Impact on Rates:
The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Investment returns are likely to remain relatively low during 2016/17 and beyond

- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing Strategy

Apart from the borrowing relating to the Mersey Gateway (discussed in 3.5) the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), 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 is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Operational Director - Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

3.5 Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure 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.

The Council is asked to approve the following treasury indicators and limits:

Table 9 – Upper limit for interest exposure

Upper Limit for Interest Rate Exposure	2016/17 %	2017/18 %	2018/19 %
Fixed Rate	100	100	100
Variable Rate	30	30	30

Table 10 – Maturity structure of fixed rate borrowing

Maturity Structure of Fixed Rate Borrowing	2016/17	
	Lower	Higher
Under 12 months	0%	40%
12 months to 24 months	0%	40%
24 months to 5 years	0%	40%
5 years to 10 years	0%	40%
10 years and above	0%	100%

3.6 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Due to very favourable interest rates available from the PWLB, the Council borrowed £113m during 2014/15 to fund the Mersey Gateway Project. The first payments relating to Mersey Gateway will be made in 2016/17, with the remainder being made in 2017/18. The Council will be in an over-borrowed position until the second milestone payment is made towards the end of 2016/17 (see table 5)

The funds borrowed have been invested in line with the Council's Investment Strategy and the net cost of this borrowing (interest payable net of investment income) has been analysed separately to the Council's other Treasury Costs. As the cost of this borrowing (interest and MRP) will be funded from the future revenue raised by the Mersey Gateway, this will have no effect on the Council's revenue budget and has therefore been excluded from the prudential indicators shown throughout Section 2.

3.7 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. However, these savings will need to be considered in the light of the current treasury position and the size 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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then yield.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed below and are split between 'specified' and 'non-specified' investment categories. These will be used in line with the Creditworthiness Policy, and Counterparty List detailed in 4.2 and 4.4 below:

Specified investments

These are sterling denominated with maturities up to a maximum of 1 year and include the following:

- Debt Management Agency Deposit Facility
- UK Government Gilts
- Bonds issued by an institution guaranteed by the UK Government
- Term Deposits – UK Government
- Term Deposits – Other LAs
- Term Deposits - Banks and Building Societies
- Certificates of deposit with banks and building societies
- Money Market Funds (rated AAA)

Non-specified investments

These are Investments that do not meet the specified investment criteria. A variety of investment instruments will be used, subject to the credit quality of the institution:

- Term deposits – UK Government (maturities over 1 year)
- Term deposits – Other LAs (maturities over 1 year)
- Term deposits – Banks and Building Societies (maturities over 1 year)
- Certificates of deposit with banks and building societies (maturities over 1 year)
- Property Funds

At the time of investing, no more than 30% of the Council's portfolio will be held in non-specified investments

4.2 Creditworthiness Policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit ratings agencies
- CDS spreads to give early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy counties
.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised and part

nationalised UK Banks)

- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour May not be used

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored whenever new lending takes place. The Council is alerted to changes to ratings of all three agencies through its use of Capita's creditworthiness service.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data, market information, and information on any external support for banks to help support its decision making process.

4.3 Country Limits

Other than the United Kingdom, the Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch or equivalent.

4.4 Counterparty Limits for 2016/17

The Council has set the following counterparty limits for 2016/17, and will invest in line with the creditworthiness policy detailed in 4.2.

Table 11 – Counterparty limits

	Maximum Limit per institution £m
UK Government	40
Nationalised and Part Nationalised Banks with:	
- Minimum rating of A	40
- Minimum rating of BBB	20
UK Banks/Building Societies with:	
- Minimum rating of AAA	30
- Minimum rating of AA	25
- Minimum rating of A	20
- Minimum rating of BBB	10
Foreign Banks in countries with a soverign rating of AAA and:	
- Minimum rating of AAA	20
- Minimum rating of AA	10
- Minimum rating of A	5
Money Market Funds	
- Minimum rating of AAA	20
- Minimum rating of AA	10
Local Authorities	40
Note: No more than 25% of the total portfolio will be placed with one institution, except where balances are held for cash-flow purposes	

Due to the high level of investments the Council holds in relation to the Mersey Gateway project, the Counterparty limits were increased for 15/16 to ensure the Council is able to obtain the best rates available. These levels will be reviewed once the final Mersey Gateway payments have been made.

4.4 Investment strategy

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2017 1.00%
- 2018 1.75%
- 2019 2.00%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

Investment treasury indicator and limit – Total principal funds invested for greater than 365 days

These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Table 12 – Maximum principal sums invested over 365 days

Maximum principal sums invested > 365 days	2016/17 £000	2017/18 £000	2018/19 £000
Principal sums > 365 days	20	20	20

4.5 End of year investment report

At the end of the financial year, the Council will report on its investment activities as part of its Annual Treasury Report

Appendix A

Minimum Revenue Provision

Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

Statutory duty

Statutory Instrument 2008 no. 414 s4 lays down that:

- "A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."
- The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).
- There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.
- The share of Housing Revenue Account CFR is not subject to an MRP charge.

Government Guidance

Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

1. although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2. it is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for “Adjustment A”) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). From the 2016/17 financial year the Council will change this to a 2% straight line method. This change to the policy has been implemented as this:

- will aid forecasting as option 1 MRP will remain unchanged each year and enable the Council to link additional MRP costs to specific assets
- will ensure that option 1 MRP is paid off by 2065. If the reducing balance method was used, there would still be a balance of £5.4m by this date

Further detail on the changes to the MRP policy is included in Appendix B.

Option 2: Capital Financing Requirement Method

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority’s outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2
- no MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an ‘MRP holiday’). This is not available under options 1 and 2

There are two methods of calculating charges under option 3: -

a. equal instalment method – equal annual instalments
b. annuity method – annual payments gradually increase during the life of the asset

Option 4: Depreciation Method

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

Date of implementation

The previous statutory MRP requirements ceased to have effect after the 2006/07 financial year. Transitional arrangements included within the guidance no longer apply for the MRP charge for 2009/10 onwards. Therefore, options 1 and 2 should only be used for

Supported Capital Expenditure (SCE). Authorities are however reminded that the DCLG document remains as guidance and authorities may consider alternative individual MRP approaches, as long as they are consistent with the statutory duty to make a prudent revenue provision.

Strategy Adopted for 2016/17 and future years

In order to determine its MRP for 2016/17 and taking into consideration the available options the Council has applied the following strategy:

- For all capital expenditure incurred before 2009/10 and for all capital expenditure funded via supported borrowing MRP to be calculated using Option 1 – The Regulatory Method (which has now been amended to a 2% straight-line charge)
- For all capital expenditure incurred from 2009/10 financed by prudential borrowing MRP to be calculated using Option 3 the Asset Life Method, with the MRP Holiday option being utilised for assets yet to come into service use
- For Mersey Gateway expenditure the options above will not be used. The MRP Holiday option will be utilised until the Council receives toll income to repay outstanding capital expenditure. MRP payments will then be matched with income received.
- Expenditure funded through the Regional Growth Fund is currently utilising the MRP holiday option. If the conditions are not met, MRP will be payable using the Asset Life Method.
- For credit arrangements such as on-balance sheet leasing arrangements (finance leases) the MRP charge will be equal to the principal element of the annual rental.
- For on balance sheet PFI contracts MRP charge will be equal to the principal element of the annual rental.
- For assets that have an outstanding balance in the Capital Adjustment Account at the time of disposal, the Council have the option of using the capital receipts raised from the sale to repay the balance. Although this will not affect the MRP charge in year (this will be a direct charge from Capital Receipts Reserve to the Capital Adjustment Account) this will reduce an MRP charge for future years. Please note:
    - If the sale of the asset does not raise sufficient receipts to repay the outstanding balance the council has the option to use the Capital Receipts Reserve to make the repayment
    - If the Council choose not to use the methods detailed above, the MRP should be repaid over a period that is considered prudent

Appendix B

Changes to the 2016/17 MRP Policy

Change 1 – 2% straight line for spend before 1st April 2008

Introduction

The Council currently provide for Capital Expenditure before 1 April 2008 using option 1. This method treats this expenditure as if the old regulations are still in place.

This is calculated by taking the Council's Capital Financing Requirement (CFR) which relates to this spend, deducting Adjustment A (which was set in 2004 to balance the new system) and then charging on a 4% reducing balance basis.

The change that we are implementing from 1 April 2016 is to charge expenditure relating to before 1 April 2008 on a 2% straight line charge over the next 50 years, rather than a 4% reducing balance.

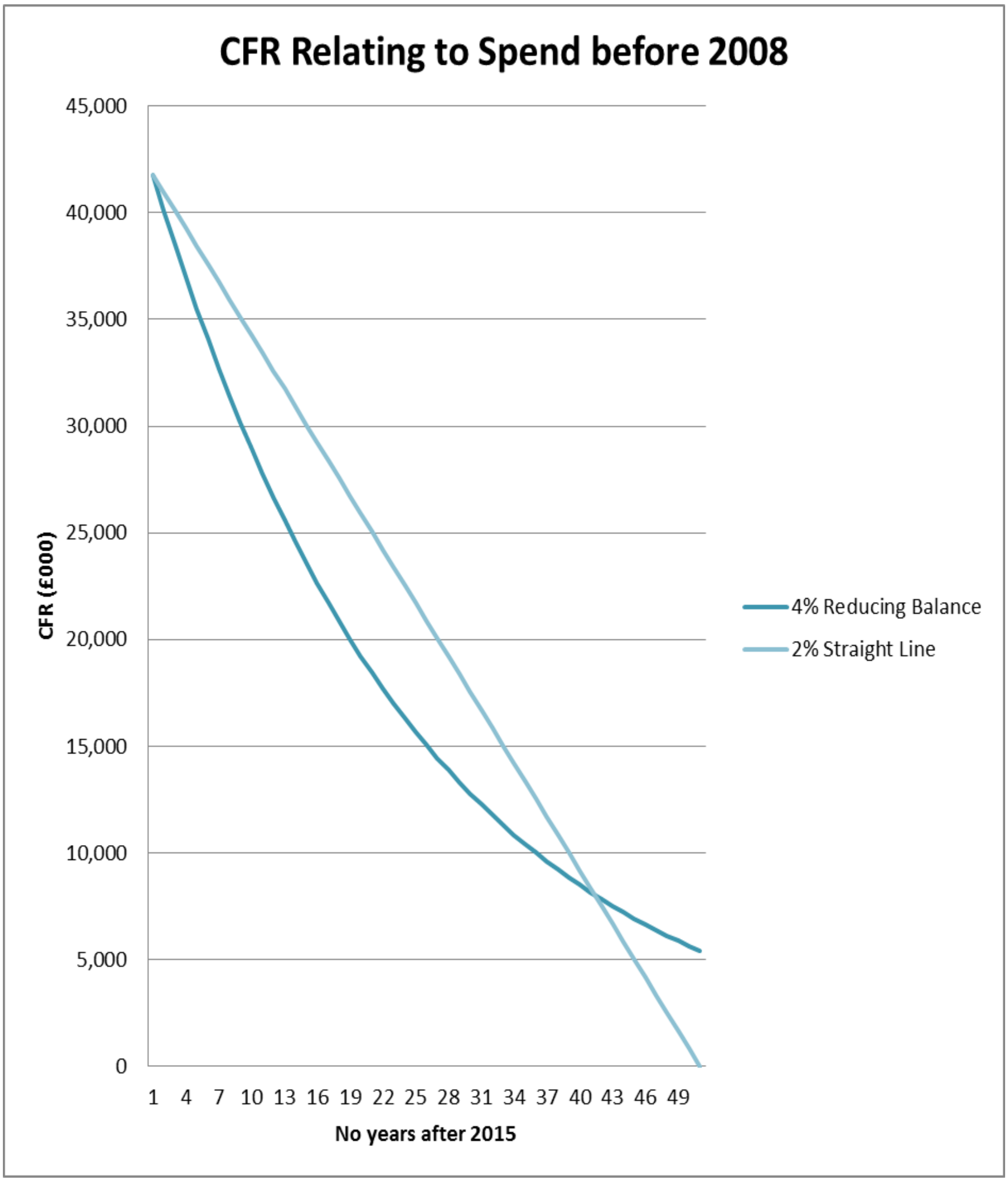
Why are we changing the policy?

There are a number of advantages to the Council of changing the MRP charge to 2% straight line. These are detailed below:

- Using the reducing balance method, on 1 April 2065 the CFR relating to pre-2008 spend would still have a balance of £5.4m. By using the 2% straight line method the CFR relating to this spend will be reduced to zero by this date. This is therefore considered the most prudent approach to the repayment of debt. The impact on the CFR is shown on the graph on the following page. It can be seen that although the CFR relating to spend before 2008 drops at a slower rate, it is totally repaid within 50 years, whereas the 4% reducing balance method will never reach zero.

- This will ensure the Council pays the same amount of MRP (relating to spend pre April 2008 Capital Spend) every financial year. As spend after April 2008 is linked directly to capital projects this makes it easier to monitor the MRP charge and link annual changes directly to capital schemes.

- In comparison to the reducing balance basis, the change in MRP policy will reduce expenditure on MRP by £835k in 2016/17. This will continue to have a positive effect on the MRP charge until 1 April 2034.



Change 2 – Use of Capital Receipts to repay MRP

Introduction

For capital expenditure after 1st April 2008, the Council follows Option 3 in the MRP Guidance notes and charges MRP on a straight line or annuity basis (based on the type of scheme) over the life of the asset.

Currently when an asset is sold or disposed of, the MRP relating to that asset will continue to be paid off over the life of the asset, even if the Council no longer owns this asset. Any income made from the sale of the Asset will be paid into the Capital Receipts Reserve to fund future capital schemes.

The change suggested is to enable the Council to use the capital receipts made from the sale of an asset to repay any outstanding MRP relating to that scheme. Also if an asset is disposed of (or the income received is less than the outstanding MRP) the Capital Receipts Reserve could be used to repay the MRP.

It should be noted that this change is only an option. For strategic reasons (or if there are no capital receipts available) the Council may decide not to use the capital receipts for this purpose.

Why are we changing the policy?

By changing the treatment of MRP on disposed assets, for any expenditure after 1st April 2008:

- The council will only be charged for assets they hold

- This will enable the council to reclaim capital expenditure from the sale of an asset

- The change will enable the council to use asset management in a more strategic way by matching spend and income to specific assets