TRAFFORD COUNCIL

Report to:	**Accounts & Audit Committee** **Executive & Council Meetings**
Date:	**7 February 2017** **22 February 2017**
Report for:	**Decision**
Report of:	**The Executive Member for Finance and Chief Finance Officer**

<u>Report Title</u>

TREASURY MANAGEMENT STRATEGY 2017/18 – 2019/20

<u>Summary</u>

This report outlines the:-

- strategy to be followed during this period for investments and borrowing,
- outlook for interest rates,
- management of associated risks,
- policy to be adopted on Minimum Revenue Provision (MRP) and
- Prudential Indicators.

<u>Recommendations</u>

That the Accounts & Audit Committee & Executive recommend to Council for approval the:

- policy on debt strategy as set out in section 3;
- investment strategy as set out in section 5;
- Prudential Indicators and limits including the Authorised Limit (as required by section 3(1) of the Local Government Act 2003), Operational Boundary, Minimum Revenue Provision Statement and Investment criteria as detailed in Appendix 3.

<u>Contact person for access to background papers and further information:</u>

Name: Graham Perkins
Extension: 4017

Background papers: None

Relationship to Policy Framework / Corporate Priorities	Value for Money
Financial	The treasury management strategy will aim to maximise investment interest whilst minimising risk to the Council. The Council's debt position will be administered effectively and any new loans taken will be in-line with the Medium Term Financial Plan provision.
Legal Implications:	Actions being taken are in accordance with legislation, Department of Communities & Local Government (DCLG) guidance, Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code and Treasury Management Code of Practice.
Equality/Diversity Implications	Any equality and diversity implications are as set out in this report
Sustainability Implications	Not applicable
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities and these factors have been incorporated into the treasury management systems and procedures which are independently tested on a regular basis. The Council's in-house treasury management team continually monitor risks to ensure that the main risks associated with this function of adverse or unforeseen fluctuations in interest rates are avoided and security of capital sums are maintained at all times.
Health and Safety Implications	Not applicable

Summary

The purpose of this report outlines the expected treasury management activities for the forthcoming three years and has been prepared in accordance with the Council's Financial Procedure Rules. Additional treasury management reports are produced during the course of the year reporting actual activity for the preceding year and a mid-year update.

Economic position (Appendix 2)

The World economic situation continues to be fragile and with several significant influences expected in 2017, Brexit exit terms to commence, Presidential elections in Holland, France & Germany and a new US President, the outlook is forecasted not to change from this position.

During 2016 the main economic headlines were:

- The UK's economy remains one of the strongest of the G7 nations, MPC cut the Bank Rate from 0.50% to 0.25% and at the same time increased quantitative easing by £60bn. Unemployment remained at 4.8% in October, its lowest level since July 2005;
- Italian & some German banks remain under capitalised and Spain has joined Greece in having to introduce highly unpopular austerity cuts;
- After a sluggish start to the year, the US continues to report strong positive growth and its unemployment rate fell to 4.6%, its lowest level since August 2007;
- China's reported the same quarterly growth rate for the first 3 quarters in 2016 of 6.7% leading some commentators to strongly suggest that figures are being massaged.
- Japan's growth rate remained fragile and deflation remains a major issue.

Debt (Section 3)

Borrowing interest rates are forecasted to continue at low levels during the next 12 months with only minor increases expected during this period. Any new external borrowing will be taken in order to (a) assist finance the Council's capital borrowing requirement as outlined in the 2017/20 Capital Programme report and (b) commence to address the current underborrowed position, with all associated costs being contained within the the Council's Medium Term Financial Plan.

Debt restructuring exercises will only be undertaken in order to produce revenue savings or lower overall treasury risk.

Investments (See Section 5 and Appendix 3)

The main objective surrounding the Council's investment criteria remains unchanged from that previously adopted of security of capital first, liquidity of its cash flows and finally yields.

The Council is required to agree the lending criteria, which is primarily determined by credit ratings issued by the 3 major credit rating agencies as detailed at Appendix 3.

Prudential Indicators and limits (Section 7 and Appendix 3)

The Council is required to approve a set of Prudential Indicators and limits which ensure the Council's capital expenditure plans and borrowing remain robust, prudent, affordable and sustainable. These are detailed at Appendix 3 for Member approval.

1. Background

1.1 The Council is required to operate a balanced budget, which 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.

1.2 Another function of this 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. On occasion any existing loans may be restructured to meet Council risk or cost objectives.

1.3 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."

1.4 All transactions undertaken as part of the treasury management operation will comply with all the statutory requirements together with the DCLG Guidance, CIPFA Treasury Management Code of Practice which the Council has adopted. A brief outline of these has been provided at Appendix 1.

1.5 Members are required to receive, a minimum of 3 reports annually as follows;

- **Prudential and treasury indicators and treasury strategy** (February, this report) - The first, and most important report covers:
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time) and
  - the treasury management strategies (how the investments and borrowings are to be organised) including treasury indicators.
- **A mid-year treasury management report** – (November) - This will update members with the progress of the treasury management position, amending prudential indicators as necessary, and whether any policies require revision.
- **An annual treasury report** – This provides details of actual treasury operations undertaken in the previous year.

1.6 The above 3 reports are required to be adequately scrutinised before being recommended to the Council and this role is undertaken by the Accounts & Audit Committee.

1.7 The Council uses Capita Asset Services as its treasury management advisors who provide a range of services on all treasury matters from the supply of credit ratings to technical support. The Council recognises that there is value in employing external providers for this service in order to acquire access to specialist skills and resources and the provision of this service is subject to regular review.

1.8 Whilst the advisors provide support to the internal treasury management team, the Council recognises that the final decision on all treasury management matters remains with the organisation at all times.

1.9 The Council acknowledges the importance of ensuring that all members and staff involved in the treasury management function receive adequate training and are fully equipped to undertake the duties and responsibilities allocated to them.

1.10 In order to assist with this undertaking a member training event was provided on 30 January 2017 and access to further similar events when they occur will be made available. Officers will continue to attend courses / seminars presented by CIPFA, Advisors and any other suitable professional organisation, in accordance with Council policy on this issue.

1.11 Excluded from this report are the activities carried out by the Council's schools, which operate within separate criteria as stipulated by the Chief Finance Officer and in accordance with the Council's Financial Procedure Rules.

2. Economic & Interest Rate forecast

2.1 The general overall world economic position continues to remain in a delicate place and whilst both the UK & USA reported positive growth outturns for 2016, this has slowed during the latter part of the year in response to the decline of both China and India growth propects, uncertainty around Brexit and the new presidency of the USA.

2.2 Further details on the major economic events which occurred during 2016 and forecasts for 2017/18 are outlined at Appendix 2 for reference.

2.3 Capita produces interest rate projections periodically throughout the year and the current forecasts, up to March 2020, are highlighted in the table below;

	2016-17 Forecast %	2017-18 Forecast %	2018-19 Forecast %	2019-20 Forecast %
Bank Rate	0.28	0.25	0.25	0.63
Investment Rates (LIBID)				
3 month	0.33	0.20	0.38	0.70
1 Year	0.66	0.65	0.78	1.15
PWLB Loan Rates				
5 Year	1.17	1.10	1.20	2.25
25 Year	2.51	2.40	2.50	3.55

2.4 Over the next few years, the Council will continue to adopt a cautious approach to its treasury management activities in response to the uncertain direction the world economic situation will take and this course of action is in accordance with the guidance from Capita, the Council's treasury management advisors.

3. Debt Strategy 2017/18 – 2019/20

3.1 The Council has the powers to borrow new funds from other local authorities or the the Government using the Public Works Loan Board, (PWLB), dedicated publicly funded companies set up soley to lend funds to the public sector e.g. Salix, the Municipal Bond Agency which is currently still in the process of being set up or from financial institutions within the money market. All funds obtained will be taken in order to assist short term cash flow or finance longer term capital investment.

3.2 The table below shows the actual current levels of external debt, together with forward projections and compares this to the underlying capital borrowing need (the Capital Financing Requirement - CFR). In addition to this the Council's under-borrowing position is highlighted for reference.

	2016/17	**2017/18**	**2018/19**	**2019/20**
	Estimate £000	**Estimate £000**	**Estimate £000**	**Estimate £000**
Debt at 1 April	104,221	109,882	132,037	133,519
External Debt maturing	(3,747)	(3,624)	(3,518)	(4,160)
New External Debt	9,408	25,779	5,000	0
Debt at 31 March	109,882	132,037	133,519	129,359
Capital Financing Requirment at 31 March	144,664	168,800	170,384	167,284
Under borrowing at 31 March	34,782	36,763	36,865	37,925

3.3 It can be seen from the above table that the Council is currently maintaining an under-borrowed position arising from decisions taken previously not to finance capital spending from new external loans. Instead cash supporting the Council's reserves, balances and cash flow has been temporarily used to finance this requirement. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

3.4 The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances within the 2017/18 treasury operations. Any new borrowing undertaken will be to (a) assist finance the Council's capital Investment programme and (b) start to replace funds previously used to finance capital spend (underborrowed position) and will be subject to favourable interest rates and budget provision being available permitting this course of action.

3.5 The Council holds £59.7m of Market loans and of these £40m are held as variable rates of interest in the form of Lender's Option Borrower's Option (LOBO) loans. On this type of loan, the lender has the option to propose an increase in the interest rate at set dates and should this situation occur then the Council has the option to either accept the new rate or to repay the loan at no additional cost. Although the Chief Finance Officer understands that lenders are unlikely to exercise their option in the current low interest rate environment, there remains a possiblity that this could occur. In accordance with the Chief Finance Officer's delegated authority, should an opportunity present itself to repay a LOBO loan at no cost, then this option will be taken and a decsion made about whether it is prudent to take a replacement loan from the PWLB. The remainder of Market loans, £19m are held at fixed rates of interest.

3.6 In addition to the borrowing undertaken directly, the Council is also responsible for a further £0.7m which is administered by Tameside Borough Council. This follows the conversion in February 2010 of loans previously held on behalf of Manchester International Airport into an equity rated instrument.

3.7 As short term borrowing rates are cheaper than longer term fixed interest rates, there may be potential opportunities in the future to generate revenue savings by switching from long term debt to short term debt. However the cost of premiums incurred, due to early repayment, will also need to be taken into account before any restructuring is undertaken.

3.8 The Council retains the flexibility to borrow funds in advance of requirement should market conditions unexpectedly change i.e. anticipate a sharp rise in interest rates, and any decision to borrow in advance will ensure that funds are taken within forward approved Capital Financing Requirement estimates.

3.9 Any borrowing in advance of requirement taken by the Chief Finance Officer will be done in accordance with delegated powers and within the constraints stated below;

- no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period is to be obtained in this manner and
- borrowing only up to a maximum 12 months in advance of need.

3.10 The Council's debt maturity profile as at 31 March 2017 is provided at Appendix 4 for reference which also shows, in accordance with the Code of Practice, the potential first date the lending banks could amend the rate of interest for the market loans.

3.11 In accordance with the Code of Practice, no new borrowing will be taken in order to lend out to solely make a profit.

3.12 The Council is required to approve;

- the above debt strategy and
- as part of the Prudential Indicators and Limits requirement, the limits for external debt in accordance with the Local Government Act 2003, having regard to CIPFA's prudential code before the commencement of each financial year. These limits are detailed at Appendix 3 for Council approval.

4. Minimum Revenue Provision Strategy

4.1 The Council is required to set aside an amount each year for the repayment of debt (by reducing the CFR), through a revenue charge called the Minimum Revenue Provision (MRP). In addition, the Council is also allowed to undertake Voluntary Revenue Payments (VRP).

4.2 Previously within the Revenue Support Grant (RSG) there has been an element of contribution which was to finance MRP incurred on supported capital borrowing however due to austerity measures, this provision has been eroded. In response to this, the Council in 2015/16, reviewed the way it calculated its MRP for this element of debt and a more appropriately linked policy of using the average useful life of its assets was adopted and applied effective from 1 April 2015.

4.3 During 2016/17 further work has been undertaken to establish what the effect would be had this policy been adopted on this element of debt from 1 April 2007 and as a result it was established that the Council has, during the period 2007/08 to 2014/15, previously over-provided MRP by £9.93m.

4.4 The Council intends to phase the reduction of £9.93m to the annual MRP charge over the next four years with the unused MRP budget transferred to an earmarked reserve. This action will;

- ensure that a MRP provision on the Supported debt element within the CFR held during the period 2007/08 – 2014/15 is calculated using the same method as that applied in 2015/16;
- enable debt to be written off quicker than previously permitted i.e. debt incurred in 2007/08 will now be completely written off by 2059/60 rather than 2064/65,
- enable the local council tax payer to receive the benefit of this over-provision in today's cash values rather than at reduced value due the effects inflation will have on this over the next 50 years.

4.5 This action does not change the current MRP policy as approved by Council at its February 2016 meeting and no changes to this are proposed for 2017/18. Further detail on this aspect can be found on page 19 of this report.

4.6 Members are requested, as detailed at Appendix 3 to;

- approve the annual MRP statement and
- note the revised approach to the existing MRP policy.

5. Investment Strategy

5.1 The Council undertakes investments, from income temporarily available which has been received in advance of spend and from its balances and reserves which it holds. This function is undertaken with regard to the DCLG's Guidance on Local Government Investments together with the revised CIPFA Treasury Management in Public Services Code of Practice.

5.2 The primary principle governing the Council's investment criteria is the security of its investments, followed by liquidity whilst ensuring that a reasonable level of return is also achieved. In addition to these main principles, the Council maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and subsequent monitoring of them. These areas are set out in more detail for reference within the Specified and Non-specified investment sections at Appendix 3.

5.3 Whilst counterparty risk appears to have eased, the markets are still subject to periods of extreme volatility and as a consequence, returns from deposits continue to remain historically low. Whilst every endeavour will be taken by the Council's in-house treasury management team to ensure that the Council receives a reasonable rate of return on its investments, recent history and market warnings will not be ignored when searching for that extra return to ease revenue budget pressures.

5.4 To ensure that investments are only placed with strong creditworthy institutions, a counterparty list is produced and maintained based on credit ratings from two of the three independent rating agencies (Fitch, Moody's and Standard and Poor's) and these must meet the minimum levels required by the Council as shown at Appendix 3.

5.5 This approach uses real time credit rating information provided by the Council's advisers Capita and enables an institution should they meet the minimum credit criteria required to be immediately included on to the list of approved institutions or removed if they no longer meet the minimum criteria.

5.6 Whilst investment risk will never completely be eliminated, it can be minimised and in order to reduce the risk of an institution defaulting, the Chief Finance Officer recommends that the Council continues with the current practice of institutions only being included on the Council's lending list which have a minimum credit rating as follows;

- Short Term – Fitch F1 or equivalent
- Long Term – Fitch A- or equivalent.

5.7 A full explanation of the credit ratings determining the institutions which the Council will use can be found at Appendix 5.

5.8 Whilst Members are asked to approve these base criteria, the Chief Finance Officer may temporarily restrict further investment activity to those institutions considered of higher credit quality than the minimum criteria set out for approval should any exceptional market conditions be encountered.

5.9 The Council's in-house treasury management team further recognises that ratings are not the sole determinant of the quality of an institution and it is important to continually assess and monitor each institution in relation to the economic and political environments in which they operate. For this purpose, the Council will with the assistance of its advisers, monitor market opinions, financial press, equity & credit default swap prices and overlay this information on top of the credit ratings. This additional market information is detailed for Members' reference at Appendix 5.

5.10 In addition to the Council's list of high quality investment institutions, further factors will also be used in order to reduce any potential exposure of its investments including time and value limits as explained in more detail at Appendix 3 together with how much in total can be placed in non-UK institutions, Groups and Sectors which is shown in more detail at Appendix 5.

5.11 Investments will continue to be placed into three categories as follows;

- Short-term – cash required to meet known cash flow outgoings in the next month, plus a contingency to cover any unexpected transaction over the same period with bank call accounts, money market funds and certificates of deposits being the main methods used for this purpose.
- Medium-term – cash required to manage the annual seasonal cash flow cycle covering the next 12 months and will generally be in the form of fixed term deposits and enhanced money market funds.
- Long-term – cash not required to meet any forthcoming cash flow requirements which can be used primarily to generate investment income by using fixed or structured term deposits, certificates of deposits, government bonds or the Local Authority Property Investment fund, after taking into consideration the forecasted interest rate yield curve.

5.12 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 and be limited to the Prudential Indicator detailed at Appendix 3.

5.13 The level of the Council's investments together with the average interest rate, as at 31 December 2016, is provided for reference at Appendix 6.

5.14 The Council is requested to approve;

- the adoption of the above Investment strategy and
- the minimum criteria for providing a list of high quality investment institutions, instruments and limits to be applied as set out at Appendix 3.

6. Investment Risk Benchmarking

6.1 The CIPFA Code of Practice and DCLG Investment Guidance require that appropriate security and liquidity benchmarks are considered and reported to Members and these are explained in more detail in Appendix 5.

6.2 These benchmarks are simple guides to maximum risk (not limits) for use with cash deposits and so may be exceeded from time to time, depending on movements in interest rates and institution criteria. The purpose of the benchmark is to assist officers to monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported to Members, with supporting reasons in the Mid-Year or Annual Report. For reference these benchmarks proposed are;

- Security - each individual year the security benchmark is:

1 year investments	2 year investments	3 year investments
0.07%	**0.02%**	**0.08%**

Note - This benchmark is an average risk of default measure and would not constitute an expectation of loss against a particular investment.

- Liquidity – Weighted Average Life (WAL) - benchmark for 2017/18 is set at 6 months, with a maximum of 3 years for cash time deposits;

  Liquid short term deposits - at least £10m is available within a week's notice.

- Yield - Internal returns are required to achieve above the 7 day London Interbank Deposit (LIBID) rate.

7. Prudential Indicators

7.1 A number of prudential indicators have been devised for the treasury management operation and these are designed to assist managing risk and reducing the impact of an adverse movement in interest rate. These indicators have been set at levels which do not prevent day to day activities being undertaken and at the same time ensure the Council's capital expenditure plans are prudent, affordable and sustainable.

7.2 Members are requested to approve the Prudential Indicators for Council's treasury management activities as detailed at Appendix 3.

8. Related Treasury Issues

8.1 Local Authority Mortgage Scheme. Under this scheme, which is designed for first time buyers to be able purchase a property in the area, the Council placed funds totalling £3m with Lloyds bank for a period of 5 years to match the 5 year life of the indemnity. This scheme is now approaching its conclusion and these monies will be repaid back to the Council by Lloyds over the next 2 years.

8.2 Greater Manchester Pension fund. The Greater Manchester Pension Fund has been working with its local council partners concerning the prospect of councils making employer pension contributions of up to 3 years in advance into the Fund. As result of this action the Fund would be able to use these monies to generate a more favourable return which in turn will enable the Councils to receive a discount on the amount it is expected to pay over into the fund under this scheme. During 2017/18, the Council is expected to take advantage of this opportunity and make a payment for approximately £39m (net of discount of £2.5m) covering 3 years of employer pension contributions for the period 2017/18 to 2019/20.

8.3 Investment Properties. At its meeting on 19 December 2016, Members of the Executive approved a report which outlined proposals for a new approach to be adopted involving the acquisition of property which would generate an income stream. The Council's initial level of investment for this purpose would be approximately £20m.

8.4 Whilst the above 3 projects are policy related activities and therefore not deemed to be treasury management, their implementation will have an impact on the Council's cash flow as well as the investing and borrowing activities and it is this aspect which Members need to be aware of.

9. Recommendations

That the Accounts & Audit Committee and Executive recommend to Council the key elements of this report for approval which are as follows;-

- policy on debt strategy as set out in section 3;
- investment strategy as set out in section 5;
- Prudential Indicators and limits including the Authorised Limit (as required by section 3(1) of the Local Government Act 2003), The Minimum Revenue Provision Statement and Investment criteria as detailed in Appendix 3.

Other Options

This report has been produced in order to comply with Financial Procedure Rules and relevant legislation. It provides a plan of action for the period 2017/18 to 2019/20, which is flexible enough to take account of changes in financial markets. There are an almost infinite number of other options that the Council could consider as part of its treasury management activities. However, this report outlines a coherent and prudent approach which is recommended by the Chief Financial Officer to the Council.

Consultation

Advice has been obtained from Capita, the Council's external advisors.

Reasons for Recommendation

The Financial Procedure Rules, incorporating the requirements of the revised CIPFA Prudential Code and the CIPFA Treasury Management Code requires that the annual strategy report is provided to the Council as an essential control over treasury management activities. In it the Council approves the parameters under which officers will operate. In addition The Local Government Act 2003 requires that the Council approves an annual borrowing limit (the Authorised Limit) and DCLG Guidance an annual investment strategy (setting out the limits to investment activities) prior to the commencement of each financial year.

Key Decision

This will be a key decision likely to be taken in: February 2017

This is a key decision currently on the Forward Plan: Yes

Finance Officer Clearance *…NB…*

Legal Officer Clearance *…MRJ.*

Director's Signature Joanne Hyde

Joanne Hyde

APPENDIX 1

STATUTORY FRAMEWORK

Local Government Act 2003

In accordance with the Local Government Act 2003 (and supporting regulations and guidance) each Council must before the commencement of each financial year, produce a report fulfilling three key requirements as stipulated below;

- The debt strategy in accordance with the CIPFA Code of Practice on Treasury Management (section 3);
- The investment strategy in accordance with the DCLG investment guidance (section 5);
- The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities (Appendix 3).

CIPFA Code of Practice

The Council's treasury activities are strictly regulated by statutory requirements in conjunction with a professional code of practice (the CIPFA Treasury Management Code of Practice). This Council adopted the Code of Practice on Treasury Management on 24 April 2002 and followed recommended practices by considering an annual Treasury Management Strategy before the commencement of each financial year. These Codes are revised from time to time and the Council complies with any revisions.

Investment Guidance

DCLG issued Investment Guidance in March 2010 and this forms the structure of the Council's policy below:

- The strategic guidelines for decision making on investments, particularly non-specified investments;
- Specified investments that the Council will use. These are high security (no guidelines are given defining what this should consist of and each individual Council is required to state what this should be i.e. high credit ratings), high liquidity investments in sterling and with a maturity of no more than a year;
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time;
- The principles to be used to determine the maximum periods for which funds can be committed.

APPENDIX 2

MAIN ECONOMIC HEADLINES DURING 2016

UK -

- Annualised Gross Domestic Product (GDP) growth rates continues to be one of the strongest of the G7 countries at 2.2% y/y up to end of September 2016, this compares to 1.8% for 2015;
- Consumer Price Index (CPI) opened the year at 1.2% in January 2016 peaking at 1.5% before falling back to 1.2% in November 2016;
- Monetary Policy Committee (MPC) at its meeting 4 August 2016 reduced the Bank Rate from 0.50%, where it had been since March 2009, to 0.25%, its lowest level and increased the level of Quantitative Easing levels from £375bn to £435bn;
- The level of unemployment rate continues to fall from 5.1% in January 2016 to 4.8% in October, the lowest levels since July 2005;
- The outcome of the Brexit referendum delivered a leave result from which the Government must notify the European Council of its intention to leave in accordance with Article 50 of the Treaty on European Union which it plans to do by March 2017 after which there will be a 2 year negotiation leading to exit.

Eurozone –

- GDP continues to remain weak at 1.7% y/y up to the end of September 2016, which compares to 1.5% for 2015;
- CPI rose marginally during 2016 starting at 0.3% in January 2016 rising to 1.1% in December 2016;
- Unemployment rate fell from 10.4% in January 2016 to 9.8% in October 2016;
- Greece continues to cause a concern for the EU due to its reluctance to implement key reforms in order to make it more efficient and pay its way and following 2 inconclusive general elections in 2015 & 2016, Spain is also having to implement a package of highly unpopular austerity cuts required by the EU;
- Italian & some German banks remain under capitalised and this could become a major issue as national governments are forbidden by EU legislation from providing state aid to bail out any bank at risk;
- European Central Bank in March 2016 extended its €1.1 trillion programme of quantitative easing originally intended to run to September 2016 to December 2017 and cut its central policy rate from 0.05% to 0.00%.

US –

- GDP despite being sluggish for the first part of the year at 1.1%, however as a result of strong growth, quarter 3 ending September 2016 saw a rebound to 3.5% y/y;
- Following December 2015 there was an increase by the Federal Reserve in Bank rate from 0.25% to 0.50%. It was widely expected further increases would occur during 2016 however as a result of weak International growth

and the Brexit outcome, this increase was delayed until December 2016 when the Bank rate was increased from 0.50% to 0.75%;

- Unemployment levels continue to fall from 4.9% in January 2016 to 4.6% in November 2016, its lowest level since August 2007;
- CPI fell from its starting position at 2.2% in January, to 1.7% in November 2016;
- US remains the best positioned of the major world economies to make solid economic progress.

Other –

- China's Growth rate continues to slow from 6.8% in 2015 to 6.7% and this in turn impacts on those countries dependent on exporting raw material to it.
- Japan's economic growth remains fragile and deflation continues to remain a problem.

MAIN ECONOMIC FORECASTS FOR 2017

To be able to produce accurate economic forecasts is extremely difficult to do as so many external influences have an impact on them particularly Brexit and subsequent terms of exit, EU presidential elections scheduled for Holland, France & Germany and a new President in the US. Despite all of this forecasters are currently predicting the following levels of activity;

Indicator	UK	Eurozone	US	China
Growth Domestic Product	1.7%	1.4%	2.5%	6.6%
Consumer Price Index	1.9%	1.0%	2.3%	1.8%
Unemployment Rate	4.9%	9.8%	5.3%	4.3%
Bank Rate	0.25%	0.00%	1.25%	4.10%

Source - Trading Economics

APPENDIX 3

ELEMENTS FOR COUNCIL APPROVAL (including Prudential and Treasury Indicators, Minimum Revenue Provision & Investment Criteria)

In accordance with DCLG Guidance, the CIPFA Prudential Code and the CIPFA Code of Practice on Treasury Management each council is required to set, before the commencement of each financial year, Treasury Management Prudential Indicators and limits, a Minimum Revenue Provision Statement and Investment criteria.

The Accounts and Audit Committee and Executive are requested to recommend that Council approve these for the period 2017/18 – 2019/20 as detailed below.

TREASURY PRUDENTIAL INDICATORS AND LIMITS –

In accordance with the CIPFA Prudential code, the Council is required to produce prudential indicators and limits reflecting the expected capital activity regarding its capital investment programme. These have an impact on the Council's treasury management activities and the Council is required to approve the prudential indicators and limits affecting treasury management performance as shown below;

	2016/17 estimate £m	2017/18 estimate £m	2018/19 estimate £m	2019/20 estimate £m
Upper Limits – Fixed interest rate exposure	**3.6**	**4.2**	**4.4**	**4.2**
Upper Limits – Variable interest rate exposure	**2.6**	**2.8**	**2.8**	**2.8**
Upper Interest Limits – identifies the maximum limit for both fixed and variable interest rates exposure based upon the Council's debt position net of investments (debt interest payable less investment interest receivable).				
Authorised Limit for External debt				
-External debt (01.04)	130.0	155.0	155.0	150.0
-Other long term Liabilities (PFI)	6.0	6.0	5.5	5.5
Total	**136.0**	**161.0**	**160.5**	**155.5**
Authorised external debt limit - maximum level of external debt that the authority will require to cover all known potential requirements and includes headroom to cover the risk of short-term cash flow variations that could lead to a need for temporary borrowing. This limit needs to be set or revised by Council and is the statutory limit determined under section 3(1) of the Local Government Act 2003.				

	2016/17 estimate £m	2017/18 estimate £m	2018/19 estimate £m	2019/20 estimate £m
Operational Boundary for External debt				
-External debt (01.04)	115.0	140.0	140.0	135.0
-Other long term Liabilities (PFI)	6.0	6.0	5.5	5.5
Total	**121.0**	**146.0**	**145.5**	**140.5**
Operational boundary - calculated on a similar basis as the authorised limit but represents the likely level of external debt that may be reached during the course of the year excluding any temporary borrowing and is not a limit.				
Upper limit for sums invested over 364 days	**90**	**90**	**90**	**90**
Upper Limit for sums invested for over 364 days – these limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. Included within this limit are Manchester Airport Shares which at 31 March 2016 were independently valued at £39.6m and the Church Commissioners Local Authorities Property Investment Fund investment of £5m.				
Gross debt and Capital Financing Requirement				
-External debt (01.04)	115.0	140.0	140.0	135.0
-Other long term Liabilities (PFI)	6.0	6.0	5.5	5.5
Gross debt	121.0	146.0	145.5	140.5
-C.F.R.	144.7	168.8	170.4	167.3
Excess C.F.R.	**23.7**	**22.8**	**24.9**	**26.8**
Gross Debt and the Capital Financing Requirement – this indicator reflects that over the medium term, debt will only be for capital purposes. The Chief Finance Officer will ensure that all external debt does not exceed the capital financing requirement with any exceptions being reported to Council.				

Maturity structure of borrowing – 2017/18 to 2019/20	**Lower limit %**	**Upper limit %**
Under 12 months	0	70
12 months to 2 years	0	40
2 years to 5 years	0	40
5 years to 10 years	0	40
10 years to 20 years	0	40

Maturity structure of borrowing – 2017/18 to 2019/20 (cont.)	Lower limit %	Upper limit %
20 years to 30 years	0	40
30 years to 40 years	0	40
40 years and above	0	40
Maturity Structure of Borrowing – these gross limits are set to reduce the Council's exposure to large sums falling due for refinancing and this indicator reflects the next date on which the lending bank can amend the interest rate for the Lender Option Borrower Option loans.		

All the treasury prudential indicators and limits are monitored on a regular basis with any breaches being reported to Council at the earliest opportunity.

MINIMUM REVENUE PROVISION - (no change)

In accordance with DCLG Guidance, the Council shall determine for the current financial year, an amount of minimum revenue provision that it considers to be prudent and submit an MRP Statement setting out its policy for its annual MRP to Council for approval. The following MRP Statement has been prepared in accordance with the Council's accounting procedures and is recommended for approval:

- Capital expenditure financed by Supported Borrowing: MRP will be calculated on a straight line basis over the expected average useful life of the assets (50yrs);
- Capital expenditure financed by Prudential Borrowing: MRP will be based on the estimated life of the assets once operational charged on a straight line basis or annuity basis in accordance with the Guidance;
- PFI schemes and leases shown on the balance sheet: MRP will be based on the amount of the principal element within the annual unitary service payment and financed from the provision set-up to cover the final bullet payment. Capital receipts are to be used to replenish this provision to ensure this final bullet payment can still be made in 2028/29
- For expenditure that does not create an asset, or following the use of a Capitalisation Direction: provision will be made over a period not exceeding 20 years, in accordance with Guidance.
- In instances where the Council incurs borrowing and a third party is obliged to repay the principal (serviced debt arrangements): the Council will not charge MRP to the revenue account. An example of such an instance can be demonstrated when the Council participated in the national Local Authority Mortgage Scheme using the cash backed option with Lloyds bank. This involved the Council placing a five year deposit totalling £1m, in 2013/14, with the bank matching the five year life of the indemnities. This deposit provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The C.F.R.will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity and once received will be classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

<u>MINIMUM REVENUE PROVISION</u> – backdating of policy - (no change)

- A change to the MRP policy with regards to Supported Borrowing was approved by Council on 20th January 2016 and subsequently on 17th February 2016 as part of the 2016/19 Treasury Management Strategy Report.

- The approval enabled MRP on the Supported Borrowing element to be calculated on a straight line basis over the expected average useful life of the assets (50yrs).

- A further piece of work has been undertaken during 2016 which has now identified the opportunity to backdate the calculation of the MRP on the Supported Borrowing element, commencing from 2007/08 rather than 2015/16.

- The backdated calculation not only shows an over charge in previous years to the General Fund of £9.93 million on the Supported Borrowing element by 2015/16 but will enable the Council to completely repay this balance seven years earlier than previously calculated, at a recurrent cost of £0.50 million per annum.

- MRP is a statutory charge rather than a provision made under accounting standards and therefore the Council cannot simply restate the Statement of Accounts resulting in a £9.93 million credit back to the General Fund.

- In recognition of this the Council will phase a reduction of £9.93 million to the annual MRP charge over the next four financial years 2016/17 to 2019/20 with the unused MRP budget contained within the overall revenue budget being redirected to create an ‘Investment Fund’ Earmarked Reserve.

- The use of the ‘investment Fund’ Earmarked Reserve will be restricted to only being deployed on sustainable income generating or ‘invest to save’ i.e. revenue saving programmes or projects of work.

INVESTMENT CRITERIA – (change – Category 5)

Counterparty Selection

The Council will only use institutions which are located in a country with a minimum Sovereign Long term credit rating of AA-. The individual credit criteria, is highlighted below and for categories 1 to 4 this will be applied to both Specified and Non-specified investments. Category 5 applies only to The Church Commissioners Local Authorities Property Investment fund.

	Fitch (or equivalent) – Long Term	Maximum Group Limit	Maximum Time Limit
Category 1 – • UK & Non UK Banks (bank subsidiaries must have a parent guarantee in place), • UK Building Societies Institutions must have an individual credit rating issued by Fitch, Moody's and Standard and Poor's of: Short Term – Fitch F1 or equivalent Long Term – Fitch A- or equivalent	AA to AAA A+ to AA- A- to A	£20m £10m £5m	3yrs 1yr 1yr
Category 2 – UK Banks part nationalised - Royal Bank of Scotland. This bank or its subsidiaries can be included provided it continues to be part nationalised or meets the ratings in category1 above.	-	£20m	1yr
Category 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria.	-	n/a	1day
Category 4 – • Pooled Investment Vehicles – must be AAA credit rated – e.g. Money Market Funds, Enhanced Money Market Funds etc. • UK Government (including treasury bills, gilts and the DMO) • Local Authorities • Supranational Institutions	-	£20m	3yrs
Category 5 – • Local Authority Property Investment fund	-	£30m (Current limit £10m)	10yrs

Specified and Non Specified Investments – (no change)

In accordance with the Code of Practice, the Council is required to set criteria which identify its investments between Specified and Non Specified investments and these are classified as follows;

- Specified investments are high security and high liquidity investments with a maturity of no more than a year or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. All investments can be held under this definition,
- Non specified investments are any other type of investment not defined as specified above. A maximum of £90m is permitted to be held in this classification as detailed in Appendix 3, Prudential Indicator (5) Upper limit for sums invested over 364 days.

Instruments & Maximum period

All Investments will be undertaken in Sterling in the form of Term Deposits, Money Market Funds, Treasury Bills, Gilts or Certificates of Deposits unless otherwise stated below.

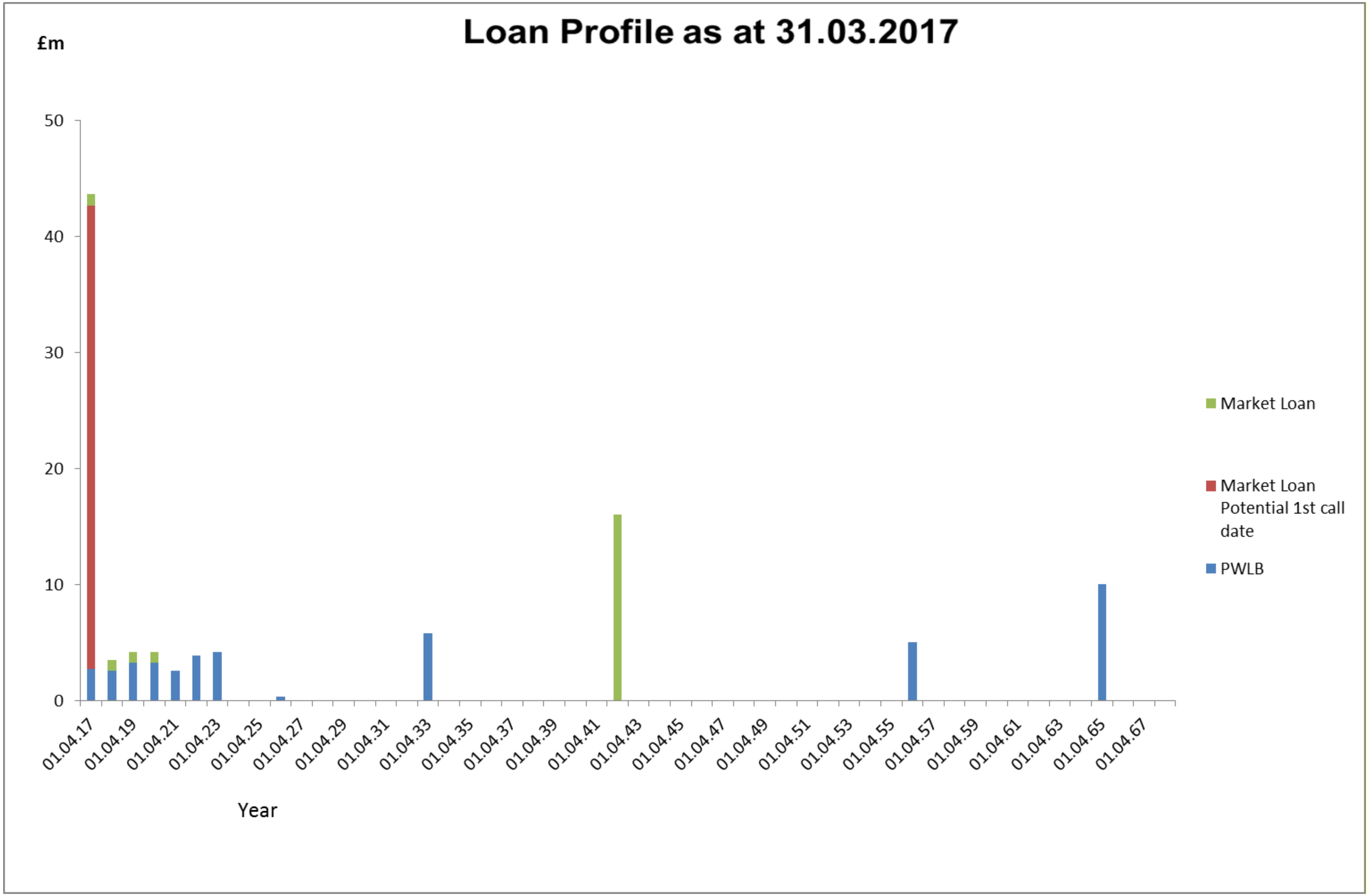
Specified Investments

Investment	Maximum Maturity
The UK Government including Local Authorities and Debt Management Office.	1 Year
Supranational bonds of less than one year duration (e.g. European Investment Bank)	1 Year
Pooled investment vehicles that have been awarded a AAA credit rating by Fitch, a credit rating agency, such as money market funds	1 Year
An institution that has been awarded a high short term credit rating (minimum F1 or equivalent) by a credit rating agency, such as a bank or building society.	1 Year

Non-Specified Investments

Investment	Maximum Maturity
Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). The security of principal and interest on maturity is on a par with the Government and these bonds usually provide returns above equivalent gilt edged securities. The value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	3 Years
Gilt edged securities. These are Government bonds and provide the highest security of interest and principal. The value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	3 Years

The Council's own bank if it fails to meet the basic credit criteria with balances being kept to a minimum.	1 Day
UK Banks which have significant Government holdings	1 Year
Any bank or building society which meets the minimum long term credit criteria detailed in Appendix 3, for deposits with a maturity of greater than one year (including forward deals in excess of 1 year from inception to repayment).	3 Years
The UK Government including Local Authorities and Debt Management Office.	3 Years
Any non-rated subsidiary of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to being guaranteed from the parent company and is included for clarity and transparency purposes.	3 Years
Share capital or loan capital in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. It is envisaged this facility will apply to the Manchester Airport share-holding which the Council holds at a historical value of £39.6m as reported in the 2015/16 Statement of Accounts. It is not envisaged that this type of investment will be undertaken in the future.	Unspecified
Manchester Airport Group – This is in response to the restructuring of the airports existing debt and is included for clarity and transparency purposes only.	Term of loans
Church Commissioners Local Authorities Property Investment Fund - This fund is aimed solely for use by public sector organisations wishing to invest in the property market whilst at the same time generating a favourable rate of return.	10 Years


Loan Profile as at 31.03.2017
£m
50
40
30
20
10
0
01.04.17
01.04.19
01.04.21
01.04.23
01.04.25
01.04.27
01.04.29
01.04.31
01.04.33
01.04.35
01.04.37
01.04.39
01.04.41
01.04.43
01.04.45
01.04.47
01.04.49
01.04.51
01.04.53
01.04.55
01.04.57
01.04.59
01.04.61
01.04.63
01.04.65
01.04.67
Year
Market Loan
Market Loan Potential 1st call date
PWLB

APPENDIX 4

APPENDIX 5

INVESTMENT CREDIT AND INSTITUTION RISK MANAGEMENT

The Council receives credit rating advice from its treasury management advisers, as and when ratings change and institutions are checked promptly to ensure it complies with the Council's criteria. The criteria used are such that any minor downgrading should not affect the full receipt of the principal and interest. Any institution failing to meet the criteria, or those on the minimum criteria placed on negative credit watch, will be removed from the list immediately, and if required new institutions which meet the criteria will be added to the list.

		Credit Rating Agency		
Classification	**Description**	**Fitch (Minimum)**	**Moody's (Minimum)**	**Standard & Poors (Minimum)**
Short Term	Ensures that an institution is able to meet its financial obligations within 12 months	F1 (Range **F1+, F2 A** to **D**)	P1 (Range **P1** to **P3**)	A1 (Range **A-1,** to **C**)
Long Term	Ensures that an institution is able to meet its financial obligations greater than 12 months	A- (Range **AAA** to **D**)	A3 (Range **AAA** to **C**)	A- (Range **AAA** to **CC**)

Investment Institution information.

Whilst the Council's Investment institutions list is prepared primarily using credit rating information, full regard will also be given to other available information on the credit quality of each institution in which it invests. The information below will continue to be considered when undertaking investments;

- Credit default swaps - CDS created in 1997 and are a financial instrument for swapping the risk of debt default. Essentially the owner of the position would enter into an agreement with a third party who would receive a payment in return for protection against a particular credit event – such as default. Whilst absolute prices can be unreliable, trends in CDS spreads do give an indicator of relative confidence about credit risk.
- Equity prices – like CDS prices, equities are sensitive to a wide array of factors and a decline in share price may not necessarily signal that the institution in question is in difficulty.
- Interest rates being paid - If an institution is offering an interest rate which is out of line with the rest of the market this could indicate that the investment is likely to carry a high risk.
- Information provided by management advisors – this may include some information detailed above together with weekly investment market updates.
- Market & Financial Press information – information obtained from the money market brokers used by the Council in respect of interest rates & institutions will also be considered.

No investment will be made with an institution if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

Investment Limits

In order to safeguard the Council's investments and in addition to the information shown at Appendix 3, due care will be taken to consider country, group and sector exposure as follows;

- **Country** – this will be chosen by the credit rating of the Sovereign state as shown at Appendix 3 and no more than 40% of the Council's total investments will be directly placed with non-UK counterparties at any time;
- **Group** – this will apply where a number of financial institutions are under one ownership (e.g. Royal Bank of Scotland / Nat West) and the Group limit will be the same as the individual limit for any one institution within that group;
- **Sector** limits will be monitored regularly for appropriateness.

Investment Risk benchmarking

Security and liquidity benchmarks are central to the approved treasury strategy through the institution selection criteria and proposed benchmarks for these are set out below.

Security - A method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table below shows average defaults for differing periods of investment grade products for each Fitch/Moody's and Standard and Poors long term rating category over the period 1981 to 2015.

Long term rating	Average 1 yr default	Average 2 yr default	Average 3 yr default	Average 4 yr default	Average 5 yr default
AAA	**0.04%**	**0.10%**	**0.18%**	**0.27%**	**0.37%**
AA	**0.01%**	**0.02%**	**0.08%**	**0.16%**	**0.23%**
A	**0.07%**	**0.19%**	**0.36%**	**0.55%**	**0.77%**
BBB	**0.15%**	**0.46%**	**0.82%**	**1.26%**	**1.73%**
BB	**0.70%**	**2.04%**	**3.48%**	**5.21%**	**6.71%**
B	**3.04%**	**7.14%**	**11.06%**	**14.40%**	**17.24%**
C	**19.73%**	**28.03%**	**33.43%**	**37.39%**	**40.41%**

The Council's minimum long term rating criteria is currently "A", meaning the average expectation of default for a one year investment in an institution with a "A" long term rating would be 0.07% of the total investment (e.g. for a £1m investment the average loss would be £700). This is only an average as any specific institution loss is likely to be higher.

Liquidity – The CIPFA Treasury Management Code of Practice defines this as "*having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable at all times to have the level of funds available which are necessary for the achievement of its business/service objectives"*.

The availability of liquidity and the period of risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio (shorter WAL would generally represent less risk).

APPENDIX 6

INVESTMENT & EXTERNAL DEBT POSITION AS AT 31.12.2016

	Principal £m	**Average Rate %**
DEBT		
Fixed rate:		
- PWLB	45.5	6.10
- Market	24.8	4.06
Sub-total	70.3	5.38
Variable rate:		
- PWLB	0.0	0.0
- Market	35.0	6.08
Sub-total	35.0	6.08
Total debt	**105.3**	**5.61**
INVESTMENTS		
- Fixed rate	(76.7)	0.72
- Variable rate	(14.4)	1.74
Total Investments	**(91.1)**	**0.88**
NET ACTUAL DEBT / (INVESTMENTS)	**14.2**	