NORTH YORKSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

1 March 2018
TREASURY MANAGEMENT

Report of the Corporate Director – Strategic Resources

1.0 PURPOSE OF THE REPORT

1.1 To recommend to the County Council an updated Annual Treasury Management Strategy for the financial year 2018/19 which incorporates:

a) the Annual Investment Strategy;

b) a Minimum Revenue Provision Policy;

c) a policy to cap Capital Financing costs as a proportion of the annual Net Revenue Budget.

2.0 INTRODUCTION AND BACKGROUND

2.1 The County 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 County Council's low risk appetite, providing adequate liquidity initially before considering investment return.

2.2 The second main function of the treasury management service is the funding of the County Council's capital plans. These capital plans provide a guide to the borrowing need of the County Council, essentially the longer term cash flow planning, to ensure that the County 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 County Council risk or cost objectives.

2.3 CIPFA defines treasury management as:
"The management of the local authority's borrowing, 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."

2.4 'Investments' in the definition above covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under the Code.

3.0 TREASURY MANAGEMENT POLICY STATEMENT

3.1 The CIPFA Code of Practice on Treasury Management (as updated in 2017) requires the County Council to approve:

a) a **Treasury Management Policy Statement** (TMPS) stating the County Council's policies, objectives and approach to risk management of its Treasury Management activities;

b) a framework of suitable **Treasury Management Practices** (TMPs) setting out the manner in which the County Council will seek to achieve the policies and objectives set out in (a) and prescribing how it will manage and control those activities. The Code recommends 12 TMPs.

c) a **Capital Strategy** setting out a high level overview of how capital expenditure, capital financing and treasury management contribute to the provision of Corporate and service objectives

3.2 The TMPS referred to in **paragraph 3.1 (a)** is attached as **Appendix A** and reflects only very minor changes for 2018/19.

3.3 The 12 TMPs recommended by the code referred to in **paragraph 3.1 (b)** which were originally submitted to Members in March 2004 were updated and approved by the Audit Committee on 6 December 2012.

4.0 ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY 2018/19

4.1 TREASURY MANAGEMENT STRATEGY

4.2 The County Council's "Authorised Limit for External Debt" is £348.9m for 2018/19, which is the maximum that can be borrowed in the year. The County Council's "Operational Boundary" is £328.9m for 2018/19, which is the maximum amount that is expected to be borrowed. Prudential indicators are a number of key indicators, which are set to ensure that the County Council operates its activities within well-defined limits.

Long Term Debt Position

4.3 In **Section 10 of Appendix B**, reference is made to the long term debt position of the County Council and the attempts being made to reduce the consequential interest charge impact on the annual Revenue Budget.

4.4 The long term debt position of the County Council is essentially related to the level of capital expenditure undertaken. The forecast for the County Council's long term outstanding debt is demonstrated by the following table:-

@ **Year End**	**Debt Outstanding £m**
2015 actual	319.8
2016 actual	316.6
2017 actual	309.0
2018 forecast	287.5
2019 forecast	285.1
2020 forecast	263.1
2021 forecast	236.0

The figures above exclude other long term liabilities such as PFI contracts and finance leases which are regarded as debt outstanding for Prudential Indicator purposes.

4.5 The current Long Term debt position reflects the policy of internally financing capital expenditure from cash balances which, at some stage, will have to be reversed. Furthermore, the forecasts for 31 March 2017 and subsequent years and the Prudential Indicators relating to external debt are based on an assumption that the annual capital borrowing requirements for the years 2017/18 to 2020/21 being taken externally each year. Consideration will be given, however, to delaying external borrowing throughout this period and funding annual borrowing requirements from revenue cash balances (i.e. running down investments). This has the potential for achieving short term revenue savings and also has the benefit of reducing investment exposure to credit risk.

4.6 The revenue cost of servicing the debt which impacts directly on the Revenue Budget / Medium Term Financial Strategy will be about £22.8m in 2018/19; this consists of interest payments of £10.7m and a revenue provision for debt repayment of £12.1m.

4.7 The debt outstanding levels of the County Council are based on the current Capital Plan. Debt levels could be reduced further by :-

(a) curtailing fresh capital investment and removing/reducing Capital Plan provisions that remain funded from external prudential borrowing;

(b) significantly increasing the Revenue Budget/MTFS provision for debt repayment above the agreed Prudential policy (about 4% of debt) that is currently made;

(c) removing Capital Plan schemes funded by capital receipts and using those receipts, together with future additional receipts and the current corporate capital pot, for debt repayment, rather than new capital investment;

(d) funding total annual borrowing requirements from internal cash balances and running down investments, and

(e) external debt could also be prematurely repaid from internal cash balances and also running down investments.

4.8 **MINIMUM REVENUE PROVISION (MRP) POLICY**

The County Council is required to determine the amount of MRP it considers prudent for each financial year. The MRP Policy is based on the Government’s statutory guidance and following review of this policy. The MRP Policy for 2018/19 has been extended to incorporate 'Assets Acquired or Developed for Resale' and 'Investment Properties'.

4.9 **ANNUAL INVESTMENT STRATEGY**

Credit Rating Criteria

4.10 The criteria for monitoring and assessing organisations (counterparties) to which the County Council may make investments (i.e. lend) are incorporated into the detailed Treasury Management Practices (TMPs) that support the Treasury Management Policy Statement (TMPS). Applying these criteria enables the County Council to produce an Approved Lending List of organisations in which it can make investments, together with specifying the maximum sum that at any time can be placed with each. The Approved Lending List is prepared, taking into account the advice of the County Council's Treasury Management Advisor, Link Asset Services – Treasury Solutions (previously Capita Asset Services – Treasury Solutions).

4.11 In order to minimise the risk to investments, the County Council will continue to apply a minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and avoidance of concentration risk. This approach has reflected the following:-

a) a system of scoring each organisation using the Link Asset Services – Treasury Solutions (Link) enhanced creditworthiness service. This service, revised to reflect continuing regulatory changes, uses a sophisticated modelling system that includes:

- credit ratings published by the three credit rating agencies (Fitch, Moodys and Standard and Poor) which reflect a combination of components (long term and short term);

- credit watches and credit outlooks from the rating agencies;

- credit Default Swaps (CDS) spreads to give early warnings of likely changes in credit ratings; and

- other information sources, including, 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.

All this information is then converted into a weighted credit score for each organisation and only those organisations with an appropriate score will fulfil the County Council's minimum credit criteria. The score is then converted into the end product of a colour code which is used to determine the maximum investment term for an organisation

b) sole reliance is not placed on the information provided by Link. In addition the County Council also uses market data and information available from other sources such as the financial press and other agencies and organisations

c) in addition to the above, the following measures also continue to be actively taken into consideration:

- institutions will be removed or temporarily suspended from the Approved Lending List if there is significant concern about their financial standing or stability;

- investment exposure will be concentrated with higher rated institutions wherever possible.

4.12 It is, therefore, proposed that the lending criteria, above, be utilised for 2018/19. These criteria are set out in full in the Annual Treasury Management and Investment Strategy 2018/19 (Appendix B).

Debt Management Office Deposit Account

4.13 The Debt Management Office (DMO) Deposit Account is an investment facility introduced several years ago by the Government specifically for public authorities. This facility is AA-rated as it is part of the HM Treasury Operations and can be regarded as lending to the Government. It is, therefore, a 100% safe house lending option. Its standard interest rate of around 0.15% is below what could realistically be achieved elsewhere for similar short term investments.

4.14 This investment option is included in the County Council's current approved lending list with a maximum investment limit of £100m. The facility was not utilised for a number of years and no investments are anticipated in 2017/18. However, The DMO account will remain on the County Council's approved Lending List as a precaution.

Approved Lending List

4.15 The current Approved Lending List is attached to this report as **Schedule C** to the Annual Treasury Management and Investment Strategy 2018/19 (**Appendix B**). The List, however, continues to be monitored on an ongoing basis and changes made as appropriate by the Corporate Director – Strategic Resources to reflect credit rating downgrades/upgrades, mergers or market intelligence and rumours that impact on the credit 'score' and colour coding.

The changes reflected in the latest Approved Lending List compared with that submitted for 2017/18 in February 2017 are listed below. Please note that the analysis below is between the version provided last year and the proposed list for 2018/19 – it is a snapshot at a point in time. It is therefore possible that there will be in year changes that are not identified in this snapshot.

(a) organisations included on the Approved Lending List which will NOT be included for 2018/19

Organisation	**Reason**
Clydesdale Bank (Trading as the Yorkshire Bank)	No longer owned by National Bank of Australia and as a result do not meet credit worthiness criteria.
Nordea Bank Finland	Now wholly owned within Nordea Bank AB

(b) organisations who continue to be included on the 2018/19 Approved Lending List, but whose Maximum Investment Duration will remain as nil until Credit Ratings and market sentiment improve

Organisation	Reason
Deutsche Bank	Due to fall in Credit Ratings

(c) organisations added to the Approved Lending List during 2017/18

Organisation	Reason
None	

4.16 Local Authorities will continue to be included on the Approved Lending List for 2018/19, although suitable investment opportunities with them are limited. As a result of the way they are financed and their governance arrangements, Local Authorities are classed as having the highest credit rating.

Specified and Non Specified Investments

4.17 Utilising the assessment of credit quality, the criteria and investment limits for **specified investments** (a maximum of 365 days) are:

- institutions which are partially owned by the UK Government, (Nationalised Banks), being limited to £85m

- other institutions achieving suitable credit scores and colour banding being limited to a maximum investment limit of between £20m and £75m (actual duration and investment limit dependant on final score/colour)

- all foreign bank transactions are in sterling and are undertaken with UK based offices

4.18 The criteria f**or Non Specified Investments** (for periods of more than 365 days) are:

- investments over 1 year to a maximum of 5 years with institutions which have suitable credit score

- the maximum amount for all non-specified investments is £5m with any one institution

Following the review of Non Specified Investments referred to in **paragraph 4.21** below, the limits for Non-Specified investments have been reviewed, in consultation with the County Council's Treasury Management advisers, to ensure the duration and investment limits are appropriate for the investment types defined in **Schedule B** of **Appendix A.** In order to extend investments to Property Funds, the maximum duration of Non-Specified Investments has increased from 2 years to 5 years. In addition, the total investment limit for Non-Specified Investments has increased from £20m to £40m.

Additional Types of Investment

4.19 The County Council may use various financial instruments for the prudent management of its treasury balances. These financial instruments are detailed in the list of Specified and

Non Specified Investments at **Schedule B** of **Appendix A**. Deposits include a variety of products including fixed term deposits, Certificates of Deposit, Money Market Funds, Gilts, Bonds and Collateralised Deposits.

4.20 Alternative investment options are continually monitored and reviewed. Treasury Management staff continue to investigate further investments options to assess whether they meet the Council's investment priorities and criteria list.

4.21 As part of the monitoring and review of investment options, Property Funds have been identified as a potential instrument for investment following discussions with the County Councils Treasury Management consultants. Property Funds are pooled investment vehicles investing in commercial property. As a result, Property Funds have been added to the schedule of Non Specified Investments at Schedule B of Appendix A. Appropriate due diligence will be undertaken before an investment of this type is undertaken. The County Council will also consult with all external members for whom it provides a Treasury Management service prior to any investment.

5.0 CAPITAL STRATEGY

5.1 In December 2017, CIPFA issued a revised Treasury Management Code of Practice and Prudential Code. The revised Codes require all local authorities to produce a Capital Strategy. The Capital Strategy provides a high level overview of how capital expenditure, capital financing and treasury management contribute to the provision of Corporate and service objectives and takes account of stewardship, value for money, prudence, sustainability and affordability. As a result, a Capital Strategy is now included as **Appendix C** to this report.

5.2 The current economic environment is resulting in low returns on traditional treasury management investments. As a result, the County Council is currently considering an alternative strategic approach to managing cash resources through alternative, non-core investments. It is anticipated that alternative investments will predominantly be considered capital expenditure and as such will included in the Capital Plan.

5.3 The Capital Strategy provides a projection of how capital expenditure plans, including alternative investment plans, impact on capital borrowing and repayment plans.

5.4 The County Council has established a Commercial Investment Board to identify, review and recommend alternative investment opportunities. An overall maximum exposure of £50m for alternative investments was approved by Executive in August 2017.

5.5 The only non-core investments currently included in the Capital Plan are the loans provided to its subsidiary companies. Loans totalling £7.96m have been advanced to subsidiary companies.

5.6 While the Commercial Investment Board is considering a range of investment options, no further non-core investments are currently included in the Capital Plan.

6.0 TRAINING

6.1 The CIPFA Code also requires that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny (i.e. the Audit Committee). An in-house training course for Members (which was also attended by officers) was provided by Link Asset Services – Treasury Solutions in September 2013.

6.2 The training needs of the County Council's staff involved in investment management are monitored, reviewed and addressed on an on-going basis and are discussed as part of the staff appraisal process. In practice most training needs are addressed through attendance at courses and seminars provided by CIPFA, the LGA and others on a regular ongoing basis.

7.0 TREASURY MANAGEMENT CONSULTANTS

7.1 The County Council uses Link Asset Services - Treasury solutions (previously Capita Asset Services) as its external treasury management advisors.

7.2 The County 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 County 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.

8.0 REVIEW BY AUDIT COMMITTEE

8.1 In its scrutiny role of the County Council's Treasury Management policies, strategies and day to day activities, the Audit Committee receives regular Treasury Management reports. These reports provide Audit Committee Members with details of the latest Treasury Management developments, both at a local and national level and enable them to review Treasury Management arrangements and consider whether they wish to make any recommendations to the Executive.

8.2 As the County Council is required to approve an up to date Annual Treasury Management and Investment Strategy before the start of the new financial year, it is therefore not realistic for the Audit Committee to review this document in advance of its submission to Executive and the subsequent consideration by County Council on 21 February 2018.

8.3 As in recent years it is therefore proposed that the Treasury Management Policy Statement (**Appendix A**) and updated Annual Treasury Management and Investment Strategy for 2018/19 (**Appendix B**) is submitted for review by the Audit Committee on 1 March 2018. Any resulting proposals for change would then be considered at a subsequent meeting of the Executive. If any such proposals were accepted and required a change to the (by then) recently approved Strategy document the Executive would submit a revised document to the County Council at its meeting on 16 May 2018.

9.0 ARRANGEMENTS FOR MONITORING / REPORTING TO MEMBERS

9.1 Taking into account the matters referred to in this report, the monitoring and reporting arrangements in place relating to Treasury Management activities are now as follows:

a) an annual (i.e. this) report to Executive and County Council as part of the Budget process that sets out the County Council's **Treasury Management Strategy and Capital Strategy** for the forthcoming financial year;

b) an annual report to Executive and County Council as part of the Budget process that sets the various **Prudential Indicators**, together with a mid year update of these indicators as part of the Q1 Performance Monitoring report submitted to the Executive (see **(d)** below);

c) **annual outturn reports** to the Executive for both Treasury Management and Prudential Indicators setting out full details of activities and performance during the preceding financial year;

d) a quarterly report on Treasury Management matters to Executive as part of the **Quarterly Performance and Budget Monitoring** report;

e) **periodic meetings** between the Corporate Director – Strategic Resources, the Corporate Affairs portfolio holder and the Chairman of the Audit Committee to discuss issues arising from the day to day management of Treasury Management activities; and

f) reports on proposed changes to the County Council's Treasury Management activities are submitted as required to the **Audit Committee** for consideration and comment.

10.0 RECOMMENDATIONS

10.1 That Members recommend to the County Council

a) the Treasury Management Policy Statement as attached as **Appendix A**;

b) the Annual Treasury Management and Investment Strategy for 2018/19 as detailed in **Appendix B** and in particular;

(i) an authorised limit for external debt of £348.9m in 2018/19;

(ii) an operational boundary for external debt of £328.9m in 2018/19;

(iii) the Prudential and Treasury Indicators

(iv) a limit of £40m of the total cash sums available for investment (both in house and externally managed) to be invested in Non Specified Investments over 365 days;

(v) a 10% cap on capital financing costs as a proportion of the annual Net Revenue Budget;

(vi) a Minimum Revenue Provision (MRP) policy for debt repayment to be charged to Revenue in 2018/19

(vii) the Corporate Director – Strategic Resources to report to the County Council if and when necessary during the year on any changes to this Strategy arising from the use of operational leasing, PFI or other innovative methods of funding not previously approved by the County Council;

c) the Capital Strategy as attached as **Appendix C**

d) that the Audit Committee be invited to review **Appendices A, B and C** and submit any proposals to the Executive for consideration at the earliest opportunity.

APPENDIX A

NORTH YORKSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

1.0 BACKGROUND

1.1 The County Council has adopted the **CIPFA Code of Practice on Treasury Management in the Public Services** as updated in 2017. This Code sets out a framework of operating procedures to reduce treasury risk and improve understanding and accountability regarding the Treasury position of the County Council.

1.2 The CIPFA Code of Practice on Treasury Management requires the County Council to adopt the following four clauses of intent:

(a) the County Council will create and maintain as the cornerstone for effective Treasury Management

(i) a strategic **Treasury Management Policy Statement** (TMPS) stating the policies, objectives and approach to risk management of the County Council to its treasury management activities;

(ii) a framework of suitable **Treasury Management Practices** (TMPs) setting out the manner in which the County Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities. The Code recommends 12 TMPs;

(b) the County Council (full Council and/or Executive) will receive reports on its Treasury Management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in the TMPs;

(c) the County Council delegates responsibility for the implementation and regular monitoring of its Treasury Management policies and practices to the Executive and for the execution and administration of Treasury Management decisions to the Corporate Director – Strategic Resources who will act in accordance with the Council's TMPS, TMPs, as well as CIPFA's Standard of Professional Practice on Treasury Management;

(d) the County Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategies and Policies.

1.3 The **CIPFA Prudential Code for Capital Finance in Local Authorities** (updated in 2017) and the terms of the **Local Government Act 2003**, together with 'statutory' Government Guidance, establish further requirements in relation to treasury management matters, namely

(a) the approval, on an annual basis, of a set of **Prudential Indicators**;

(b) the approval, on an annual basis, of an **Annual Treasury Management Strategy**, an **Annual Investment Strategy**, an annual **Minimum Revenue Provision (MRP)** policy statement and a **Capital Strategy** with an associated requirement that each is monitored on a regular basis with a provision to report as necessary both in-year and at the financial year end.

1.4 This current Treasury Management Policy Statement (TMPS) was approved by County Council on 21 February 2018.

2.0 TREASURY MANAGEMENT POLICY STATEMENT (TMPS)

2.1 Based on the requirements detailed above a TMPS stating the policies and objectives of the treasury management activities of the County Council is set out below.

2.2 The County Council defines the policies and objectives of the treasury management activities of the County Council as follows:-

(a) the management of the County Council'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;

(b) the identification, monitoring and control of risk will be the prime criteria by which the effectiveness of the treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the County Council and any financial instrument entered into to manage these risks;

(c) effective treasury management will provide support towards the achievement of the business and service objectives of the County Council as expressed in the Council Plan. The County Council is committed to the principles of achieving value for many in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

2.3 As emphasised in the Treasury Management Code of Practice, responsibility for risk management and control of Treasury Management activities lies wholly with the County Council and all officers involved in Treasury Management activities are explicitly required to follow Treasury Management policies and procedures.

3.0 TREASURY MANAGEMENT PRACTICES (TMPs)

3.1 The CIPFA Code of Practice on Treasury Management requires a framework of Treasury Management Practices (TMPs) which:

(a) set out the manner in which the County Council will seek to achieve the policies and objectives; and

(b) prescribe how the County Council will manage and control those activities;

3.2 The CIPFA Code of Practice recommends 12 TMPs. These were originally approved by Members in March 2004 and have recently been updated in the light of the new Codes from CIPFA and Statutory Guidance from the Government. These updated documents were approved by the Audit Committee on 6 December 2012.

3.3 A list of the 12 TMPs is as follows:-

TMP 1 Risk management

TMP 2 Performance measurement

TMP 3 Decision-making and analysis

TMP 4 Approved instruments, methods and techniques

TMP 5 Organisation, clarity and segregation of responsibilities, and dealing arrangements

TMP 6 Reporting requirements and management information arrangements

TMP 7 Budgeting, accounting and audit arrangements

TMP 8 Cash and cash flow management

TMP 9 Money Laundering

TMP 10 Training and qualifications

TMP 11 Use of external service providers

TMP 12 Corporate governance

4.0 PRUDENTIAL INDICATORS

4.1 The Local Government Act 2003 underpins the Capital Finance system introduced on 1 April 2004 and requires the County Council to "have regard to" the **CIPFA Prudential Code for Capital Finance in Local Authorities**. This Code which was last updated in December 2017, requires the County Council to set a range of Prudential Indicators for the next three years

(a) as part of the annual Budget process, and;

(b) before the start of the financial year;

to ensure that capital spending plans are affordable, prudent and sustainable.

4.2 The Prudential Code also requires appropriate arrangements to be in place for the monitoring, reporting and revision of Prudential Indicators previously set.

4.3 The required Prudential Indicators are as follows

- Capital Expenditure - Actual and Forecasts
- estimated ratio of capital financing costs to the Net Revenue Budget
- Capital Financing Requirement
- Gross Debt and the Capital Financing Requirement
- authorised Limit for External Debt
- operational Boundary for External Debt
- Actual External Debt
- Interest Rate Exposures
- Maturity Structure of Borrowing
- Total Principal Sums Invested for periods longer than 365 days

4.4 The County Council will approve the Prudential Indicators for a three year period alongside the annual Revenue Budget/Medium Term Financial Strategy at its February meeting each year. The Indicators will be monitored during the year and necessary revisions submitted as necessary via the Quarterly Performance and Budget Monitoring reports.

4.5 In addition to the above formally required Prudential Indicators, the County Council has also set two local ones as follows:

(a) to cap Capital Financing costs to 10% of the net annual revenue budget; and

(b) a 30% limit on money market borrowing as opposed to borrowing from the Public Works Loan Board.

5.0 ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY

5.1 A further implication of the Local Government Act 2003 is the requirement for the County Council to set out its Treasury Management Strategy for borrowing and to approve an Annual Investment Strategy (which sets out the County Council's policies for managing its investments and for giving priority to the security and liquidity of those investments).

5.2 The Government's guidance on the Annual Investment Strategy, updated in 2009, states that authorities can combine the Treasury Management Strategy Statement and Annual Investment Strategy into one report. The County Council has adopted this combined approach.

5.3 Further statutory Government guidance, last updated with effect from April 2012, is in relation to an authority's charge to its Revenue Budget each year for debt repayment. A Minimum Revenue Provision (MRP) policy statement must be prepared each year and submitted to the full Council for approval before the start of the financial year.

5.4 The County Council's Annual Treasury Management and Investment Strategy will therefore cover the following matters:

- treasury limits in force which will limit the treasury risk and activities
- Prudential and Treasury Indicators
- the current treasury position
- the Borrowing Requirement and Borrowing Limits
- borrowing Policy
- prospects for interest rates
- borrowing Strategy
- capping of capital financing costs
- review of long term debt and debt rescheduling
- minimum revenue provision policy
- annual investment strategy
- other treasury management issues
- arrangements for monitoring / reporting to Members
- Capital Strategy

5.5 The County Council will approve this combined Annual Strategy alongside the annual Revenue Budget/Medium Term Financial Strategy at its February meeting each year.

6.0 REVIEW OF THIS POLICY STATEMENT

6.1 Under Financial Procedure Rule 14, the Corporate Director – Strategic Resources is required to periodically review this Policy Statement and all associated documentation. A review of this Statement, together with the associated annual strategies, will therefore be undertaken annually as part of the Revenue Budget process, together with a mid year review as part of the Quarterly Treasury Management reporting process and at such other times during the financial year as considered necessary by the Corporate Director – Strategic Resources.

Approved by County Council 21 February 2018

APPENDIX B

NORTH YORKSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2018/19

1.0 INTRODUCTION

1.1 Treasury Management is defined as

"The management of the County Council'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 The Local Government Act 2003, and supporting regulations, require the County Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential Indicators for the next three years to ensure that the County Council's capital investment plans are affordable, prudent and sustainable.

1.3 The Act also requires the County Council to set out its **Annual Treasury Management Strategy** for borrowing and to prepare an **Annual Investment Strategy** (as required by Investment Guidance issued subsequent to the Act) which sets out the County Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. For practical purposes these two strategies are combined in this document.

1.4 This Strategy document for 2018/19 therefore covers the following

- treasury limits in force which will limit the treasury risk and activities of the County Council (**Section 2**)
- Prudential indicators (**Section 3**)
- current treasury position (**Section 4**)
- borrowing requirement and borrowing limits (**Section 5**)
- borrowing policy (**Section 6**)
- prospects for interest rates (**Section 7**)
- borrowing strategy (**Section 8**)
- capping of capital financing costs (**Section 9**)
- review of long term debt and debt rescheduling (**Section 10**)
- minimum revenue provision policy (**Section 11**)

- annual investment strategy (**Section 12**)
- other treasury management issues (**Section 13**)
- arrangements for monitoring/reporting to Members (**Section 14**)
- specified investments (**Schedule A**)
- non-specified investments (**Schedule B**)
- approved lending list (**Schedule C**)
- approved countries for investments (**Schedule D**)

1.5 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the County Council to produce a balanced Annual Revenue Budget. In particular, Section 32 requires a local authority to calculate its Budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby additional charges to the Revenue Budget arising from:-

(a) increases in interest and principal charges caused by increased borrowing to finance additional capital expenditure, and/or;

(b) any increases in running costs from new capital projects

are affordable within the projected revenue income of the County Council for the foreseeable future.

1.6 These issues are addressed and the necessary assurances provided by the Section 151 officer (the Corporate Director – Strategic Resources) in the 2018/19 Revenue Budget and Medium Term Financial Strategy report considered separately by the Executive on 30 January 2018 and approved by the County Council on 21 February 2018.

1.7 The Annual Treasury Management and Investment Strategy was approved by the County Council on 21 February 2018.

2.0 TREASURY LIMITS FOR 2018/19 TO 2020/21

2.1 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations for the County Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the **Affordable Borrowing Limit**.

2.2 The County Council must have regard to the Prudential Code when setting the Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon future Council Tax levels is acceptable. In practice, it is equivalent to the Authorised Limit as defined for the Prudential Indicators.

2.3 Whilst termed an Affordable Borrowing Limit, the spending plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability such as credit arrangements. The Affordable Borrowing Limit has to be set on a rolling basis for the forthcoming financial year and two successive financial years.

3.0 PRUDENTIAL INDICATORS FOR 2018/19 TO 2020/21

3.1 A separate Report incorporating an updated set of Prudential Indicators for the three year period to 31 March 2020, as required by the CIPFA Prudential Code for Capital Finance in Local Authorities, was also approved by the County Council on 21 February 2018.

3.2 These Prudential Indicators include a number relating to external debt and treasury management that are appropriately incorporated into this Annual Treasury Management Strategy for 2018/19.

3.3 Full details of the Prudential Indicators listed below are contained in the separate **Revision of Prudential Indicators** report.

3.4 The following Prudential Indicators are relevant for the purposes of setting an integrated Annual Treasury Management Strategy.

(a) **Capital Expenditure - Actual and Forecasts**

	£m
2016/17 actual	110.1
2017/18 estimate	118.8
2018/19 estimate	117.3
2019/20 estimate	75.6
2020/21 estimate	76.6

(b) **Estimated ratio of capital financing costs to the Net Revenue Budget**

(i) formally required indicator net of interest earned

2016/17 actual	7.5%
2017/18 probable	7.0%
2018/19 estimate	6.5%
2019/20 estimate	6.1%
2020/21 estimate	4.7%

(ii) Local Indicator capping capital financing costs to 10% of the annual Net Revenue Budget

2016/17 actual	7.7%
2017/18 probable	7.2%
2018/19 estimate	6.8%
2019/20 estimate	6.5%
2020/21 estimate	5.2%

(c) **Capital Financing Requirement (as at 31 March)**

	Borrowing £m	Other Long Term Liabilities £m	Total £m
31 March 2017 actual	322.0	5.3	327.3
31 March 2018 probable	307.0	5.1	312.1
31 March 2019 estimate	295.3	4.7	300.0
31 March 2020 estimate	283.4	4.4	287.8
31 March 2021 estimate	272.3	4.0	276.3

(d) **Gross Debt and the Capital Financing Requirement**

In order to ensure that over the medium term debt will only be for Capital purposes, the County Council should ensure that debt does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year, plus the estimate of any additional capital financing requirement for 2018/19 and the next two financial years.

The Corporate Director – Strategic Resources confirms that the County Council had no difficulty in meeting this requirement up to 2016/17 nor are any difficulties envisaged for the current or future financial years covered by this PI update to 2020/21. For subsequent years, however, there is the potential that the County Council may not be able to comply with this requirement as a result of the potential for the annual Minimum Revenue Provision (MRP) reducing the Capital Financing Requirement below gross debt. This potential situation will be monitored closely.

(e) **Authorised Limit for external debt**

	External Borrowing £m	Other Long Term Liabilities £m	Total Borrowing Limit £m
2017/18	374.9	5.1	380.0
2018/19	344.2	4.7	348.9
2019/20	352.7	4.4	357.1
2020/21	362.8	4.0	366.8

(f) **Operational Boundary for external debt**

	External Borrowing £m	Other Long Term Liabilities £m	Total Borrowing £m
2017/18	354.9	5.1	360.0
2018/19	324.2	4.7	328.9
2019/20	332.7	4.4	337.1
2020/21	342.8	4.0	346.8

(g) **Actual External Debt**

	Borrowing £m	Other Long Term Liabilities £m	Total £m
at 31 March 2017 actual	309.0	5.3	314.3
at 31 March 2018 probable	287.5	5.1	292.6
at 31 March 2019 estimate	285.1	4.7	289.8
at 31 March 2020 estimate	263.1	4.4	267.5
at 31 March 2021 estimate	236.0	4.0	240.0

(h) **Limit of Money Market Loans** (Local Indicator)

Borrowing from the money market for capital purposes is to be limited to 30% of the County Council's total external debt outstanding at any one point in time.

(i) **Maturity Structure of borrowing**

The amount of projected borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate.

	Lower Limit %	Upper Limit %
under 12 months	0	50
12 months and within 24 months	0	15
24 months and within 5 years	0	45
5 years and within 10 years	0	75
10 years and within 25 years	10	100
25 years and within 50 years	10	100

(j) **Total principal sums invested for periods longer than 365 days**

Based on estimated levels of funds and balances over the next three years, the need for liquidity and day-to-day cash flow requirements, it is forecast that a maximum of £40m of 'core cash funds' available for investment can be held in aggregate in Non-Specified Investments over 365 days.

4.0 CURRENT TREASURY POSITION

4.1 The County Council's treasury portfolio position at 31 March 2017 consisted of:

Item	Principal £m	Average Rate at 31 March 2017 %
Debt Outstanding		
Fixed Rate funding		
PWLB	289.0	4.42
Variable Rate funding	0.0	0.00
Market LOBO's	20.0	3.95
Total Debt Outstanding	309.0	4.39
Investments		
Managed in house	308.1	0.58
Net Borrowing	**0.9**	

5.0 **BORROWING REQUIREMENT AND BORROWING LIMITS**

5.1 The County Council's annual borrowing requirement consists of the capital financing requirement generated by capital expenditure in the year, plus replacement borrowing for debt repaid less a prudent Minimum Revenue Provision charged to revenue for debt payment. These borrowing requirements are set out below.

Year	Basis	£m	Comment
2016/17	actual	0	No actual external borrowing was undertaken in 2016/17. The total requirement was £13.0m
2017/18	requirement	25.9	Includes £13.0m capital borrowing requirement rolled over from 2016/17
2018/19	estimate	-9.3	The much higher figure for 2020/21 includes 'refinancing' significant PWLB loan repayments in that years.
2019/20	estimate	11.0	
2020/21	estimate	32.1	

5.2 The Prudential Indicators include an **Operational Boundary** (an estimate of the most likely, prudent but not worst case scenario of external debt during the course of the financial year) and **Authorised Limit** (the same estimate as the Operational Boundary but allows sufficient headroom (£20m) over this figure to allow for unusual cash movements).

5.4 The **Authorised Limit** therefore represents the maximum amount of external debt which the County Council approves can be incurred at any time during the financial year and includes both capital and revenue requirements. It is not, however, expected that the County Council will have to borrow up to the Limit agreed.

5.5 **The 2018/19 Limits are as follows:**

	£m
Operational Boundary for external debt	328.9
+ provision to cover unusual cash movements during the year	20.0
= Authorised Limit for 2018/19	**348.9**

5.6 All the debt outstanding estimates and the Prudential Indicators relating to external debt are based on annual capital borrowing requirements being taken externally and therefore increasing debt outstanding levels. Consideration will be given, however, to delaying external borrowing throughout this period and funding annual borrowing requirements from revenue cash balances (i.e. running down investments).

6.0 **BORROWING POLICY**

6.1 The policy of the County Council for the financing of capital expenditure is set out in Treasury Management Practice Note 3 which supports the Treasury Management Policy Statement.

6.2 In practical terms the policy is to finance capital expenditure by borrowing from the Public Works Loan Board (for periods up to 50 years) or the money markets (for periods up to 70 years) whichever reflects the best possible value to the County Council. Individual loans are taken out over varying periods depending on the perceived relative value of interest rates at the time of borrowing need and the need to avoid a distorted loan repayment profile. Individual loans are not linked to the cost of specific capital assets or their useful life span. Decisions to borrow are made in consultation with the County Council's Treasury Management Advisor (Link Asset Services – Treasury Solutions).

6.3 In addition to the PWLB the County Council can borrow from the money market (principally banks and building societies) and this is usually effected via a LOBO (Lender Option, Borrower Option). Such loans feature an initial fixed interest period followed by a specified series of calls when the lender has the option to request an interest rate increase. The borrower then has the option of repaying the loan (at no penalty) or accepting the higher rate.

6.4 Borrowing from the money market for capital purposes is limited to 30% of the County Council's total external debt outstanding at any one point in time (per **Prudential Indicator 9**).

6.5 The County Council will always look to borrow from the PWLB and money markets at the most advantageous rate. The Corporate Director – Strategic Resources will monitor this situation closely throughout the year to determine whether at any stage, money market loans are more appropriate and advantageous to the County Council than PWLB loans.

6.6 At present all County Council long term borrowing is from the PWLB or via equally advantageous money market loans. However some short term money market borrowing may take place during the financial year in order to take advantage of low interest rates or to facilitate any debt restructuring exercise.

6.7 Depending on the relationship between short term variable interest rates and the fixed term PWLB or LOBO rates for longer periods, some capital expenditure may be financed by short term borrowing from either the County Council's revenue cash balances or outside sources.

Policy on borrowing in advance of need

6.8 The Prudential Code allows external 'borrowing for capital purposes' in advance of need within the constraints of relevant approved Prudential Indicators. Taking estimated capital borrowing requirements up to 31 March 2021 any time after 1 April 2018 is allowable under the Prudential Code. There are risks, however, in such borrowing in advance of need and the County Council has not taken any such borrowing to date and there are no current plans to do so. Furthermore the County 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.

6.9 Any decision to borrow in advance of need will only be considered where there is

- a clear business case for doing so for the current Capital Plan
- to finance future debt maturity repayments
- value for money can be demonstrated
- the County Council can ensure the security of such funds which are subsequently invested

6.10 Any future consideration of whether borrowing will be undertaken in advance of need the County Council will:

- ensure that there is a clear link between the Capital Plan and maturity of the existing debt portfolio which supports the need to take funding in advance of need

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered

- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow

- consider the merits and demerits of alternative forms of funding

- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use

- consider the impact of borrowing in advance (until required to finance capital expenditure) on temporarily increasing investment cash balances and the consequent increase in exposure to counter party risk and other risks, and the level of such risks given the controls in place to minimise them.

7.0 PROSPECTS FOR INTEREST RATES

7.1 Whilst recognising the continuing volatility and turbulence in the financial markets, the following paragraphs present a pragmatic assessment of key economic factors as they are likely to impact on interest rates over the next three years.

7.2 In terms of the key economic background and forecasts, looking ahead the current position is as follows:

(a) The UK Economy

- After the UK surprised with strong economic growth in 2016, growth in 2017 has been disappointingly weak. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power. However, more recently there have been encouraging statistics from the manufacturing sector, which is seeing strong growth, particularly as a result of increased demand for exports.

- The Bank of England Monetary Policy Committee (MPC) in September 2017 switched to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon following revised inflation forecasts. The focus of the Bank of England was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation.

- At Its 2 November meeting, the MPC delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020.

- However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. If this scenario was to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

- One key area of risk to the economy is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

- Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is difficult to predict with any certainty how the economy will perform over the next two to three years.

(b) Global Economy

- **Global Outlook**. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment - inflation prospects are also generally muted. This has led to speculation that there appears to have been a fundamental shift in the correlation between levels of unemployment and inflation, which could be a result of a combination of a shift towards flexible working, self-employment, a reduction in union power and increasing globalisation. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation.

  - **Central Bank Policy.** Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures Central Banks used in reaction to the 2008 financial crash were a combination of lowering central interest rates and Quantitative Easing (QE). The key issue now is that the period of stimulating economic recovery and warding off the threat of deflation is coming to an end and will now shift to reversing those measures i.e. by raising central rates and reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks do not cause shocks to market expectations that could destabilise financial markets. The potential for central banks to get this timing and strength of action wrong are now key risks. There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE.

- **European Union (EU).** Economic growth in the eurozone had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a significant programme of QE. However, growth picked up in 2016 and has now gathered strength and momentum. However, despite providing monetary stimulus, inflation has not reached the 2% target and is unlikely to start rising until possibly 2019. The ECB has, however, announced that it will slow down its monthly QE purchases of debt from January 2018 and continue to at least September 2018.

- **USA**. Growth in the American economy was notably erratic and volatile in 2015 and 2016 and 2017 has followed that path. Unemployment in the US has fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual increase in interest rates throughout 2016 and 2017, with further increases in 2018 expected. At its September meeting, the Fed said it would start in October to gradually unwind Quantitative Easing (QE) position.

- **Asia.** Economic growth in China has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, as well as to address the level of non-performing loans in the banking and credit systems. Japan has been struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

(c) Link Asset Services Forward View

- Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments

- The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

- Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established.

- From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

- The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

- Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

  → Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate;
  → Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows;
  → A resurgence of the Eurozone sovereign debt crisis;
  → Weak capitalisation of some European banks;
  → Rising global protectionism;
  → A slowdown in progress on EU integration and centralisation of EU policy. This, in turn, impact the Euro, EU financial policy and financial markets; and
  → A sharp Chinese downturn and its impact on emerging market countries.

- The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

  → The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy;
  → UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields; and
  → The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing.

7.3 The County Council has appointed Link Asset Services – Treasury Solutions as its treasury management advisor and part of their service is to assist in formulating a view on interest rates. By drawing together a number of current city forecasts for short term (Bank rate) and longer fixed interest rates a consensus view for bank rate, PWLB borrowing rates and short term investment rates is as follows:-

	Bank Rate	PWLB Borrowing Rates				Short Term Investment Rates	
		5 year	10 year	25 year	50 year	3 Months	1 Year
	%	%	%	%	%	%	%
Mar 2018	0.50	1.60	2.20	2.90	2.60	0.40	0.80
June 2018	0.50	1.60	2.30	3.00	2.70	0.40	0.80
Sept 2018	0.50	1.70	2.40	3.00	2.80	0.40	0.90
Dec 2018	0.75	1.80	2.40	3.10	2.90	0.60	1.00
Mar 2019	0.75	1.80	2.50	3.10	2.90	0.60	1.00
June 2019	0.75	1.90	2.60	3.20	3.00	0.60	1.10
Sept 2019	0.75	1.90	2.60	3.20	3.00	0.70	1.10
Dec 2019	1.00	2.00	2.70	3.30	3.10	0.90	1.30
Mar 2020	1.00	2.10	2.70	3.40	3.20	0.90	1.30
June 2020	1.00	2.10	2.80	3.50	3.30	1.00	1.40
Sept 2020	1.25	2.20	2.90	3.50	3.30	1.20	1.50
Dec 2020	1.25	2.30	2.90	3.60	3.40	1.20	1.50
Mar 2021	1.25	2.30	3.00	3.60	3.40	1.20	1.60

7.4 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 2018/19 but to be on a gently rising trend over the next few years;

- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Otherwise, there has been little general trend in rates during the current financial year. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue costloss – the difference between borrowing costs and investment returns.

8.0 BORROWING STRATEGY 2018/19

8.1 Based on the interest rate forecast outlined in **Section 7** above, there is a range of potential options available for the Borrowing Strategy for 2018/19. Consideration will therefore be given to the following:

(a) the County 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 authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is currently prudent as investment returns are low and counterparty risk remains relatively high;

(b) based on analysis, the cheapest borrowing will be internal borrowing achieved by continuing to run down cash balances and foregoing interest earned at historically low rates . However in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;

(c) long term fixed market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintain an appropriate balance between PWLB and market debt in the debt portfolio. The current market availability of such loans is, however, very limited and is not expected to change in the immediate future;

(d) PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which would spread debt maturities away from a concentration in longer dated debt. The downside of such shorter term borrowing is the loss of long term stability in interest payments that longer term fixed interest rate borrowing provides;

(e) consideration will be given to PWLB borrowing by annuity and Equal Instalments of Principal (EIP) in addition to maturity loans, which have been preferred in recent years;

(f) PWLB rates are expected to gradually increase throughout the financial year so it would therefore be advantageous to time any new borrowing earlier in the year;

(g) borrowing rates continue to be relatively attractive and may remain relatively low for some time, as a result, the timing of any borrowing will need to be monitored carefully. There will also remain a 'cost of borrowing' with any borrowing undertaken that results in an increase in investments incurring a revenue loss between borrowing costs and investment returns.

8.2 Based on the PWLB forecasts, suitable trigger rates for considering new fixed rate PWLB or equivalent money market borrowing will be set. The aim, however, would be to secure loans at rates below these levels if available.

8.3 The forecast rates and trigger points for new borrowing will be continually reviewed in the light of movements in the slope of the yield curve, the spread between PWLB new borrowing and early repayment rates, and any other changes that the PWLB may introduce to their lending policy and operations.

External -v- internal borrowing

8.4 The County Council's net borrowing figures (external borrowing net of investments) are significantly below the authority's capital borrowing need (Capital Financing Requirement – CFR) because of two main reasons

(a) a significant level of investments (cash balances – core cash plus cash flow generated)

(b) internally funded capital expenditure.

8.5 Such internal borrowing stood at £13.0m at 31 March 2017, principally as a result of funding company loans from internal, rather than external borrowing, and not taking up any new debt for the 2011/12, 2012/13, 2013/14, 2014/15, 2015/16 and 2016/17 borrowing requirements. The level of this internal capital borrowing depends on a range of factors including:

(a) premature repayment of external debt;

(b) the timing of any debt rescheduling exercises;

(c) the timing of taking out annual borrowing requirements;

(d) policy considerations on the relative impact of financing capital expenditure from cash balances compared with taking new external debt with the balance of external and internal borrowing being generally driven by market conditions.

8.6 The County Council continues to examine the potential for undertaking further early repayment of some external debt in order to reduce the difference between the gross and net debt position. However the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007 compounded by a considerable further widening of the difference between new borrowing and repayment rates in October 2010, has meant that large premiums would be incurred by such actions which could not be justified on value for money grounds. This situation will be monitored closely in case the differential is narrowed by the PWLB at some future dates.

8.7 This internal capital borrowing option is possible because of the County Council's cash balance with the daily average being £320.7m in 2016/17. This consisted of cash flow generated (creditors etc), core cash (reserves, balances and provisions etc) and cash managed on behalf of other organisations. Consideration does therefore need to be given to the potential merits of internal borrowing.

8.8 As 2018/19 is expected to continue as a year of low bank interest rates, this extends the current opportunity for the County Council to continue with the current internal borrowing strategy.

8.9 Over the next three years investment rates are expected to be below long term borrowing rates. A value for money consideration would therefore indicate that value could be obtained by continuing avoiding/delaying some or all new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt. This would maximise short term savings but is not risk free.

8.10 The use of such internal borrowing, which runs down investments, also has the benefit of reducing exposure to low interest rates on investments, and the credit risk of counterparties.

8.11 In considering this option however, two significant risks to take into account are

(a) the implications of day to day cash flow constraints, and;

(b) short term savings by avoiding/delaying new long external borrowing in 2018/19 must be weighed against the loss of longer term interest rate stability. There is the potential, however, for incurring long term extra costs by delaying unavoidable new external borrowing until later years by which time PWLB long term rates are forecast to be significantly higher.

8.12 Borrowing interest rates are on a rising trend. The policy of avoiding new borrowing by running down cash balances has served the County Council well in recent years. However this needs to be carefully reviewed and monitored to avoid incurring even higher borrowing costs which are now looming even closer for authorities who will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt in the near future.

8.13 **The general strategy for this "Internal Capital Financing" option will therefore be to continue to actively consider and pursue this approach on an ongoing basis in order to reduce the difference between the gross and net debts levels together with achieving short term savings and mitigating the credit risk incurred by holding investments in the market. However this policy will be carefully reviewed and monitored on an on-going basis.**

Overall Approach to Borrowing in 2018/19

8.14 Given the market conditions, economic background and interest rate forecasts, caution will be paramount within the County Council's 2018/19 Treasury Management operations. The Corporate Director – Strategic Resources will monitor the interest rates closely and adopt a pragmatic approach to changing circumstances – any key strategic decision that deviates from the Borrowing Strategy outlined above will be reported to the Executive at the next available opportunity.

Sensitivity of the Strategy

8.15 The main sensitivities of the Strategy are likely to be the two scenarios below. The Corporate Director – Strategic Resources will, in conjunction with the County Council's Treasury Management Advisor, continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a significant change of market view:

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

(b) *if it were 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 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 taken whilst interest rates are still lower than they will be in the next few years.

9.0 CAPPING OF CAPITAL FINANCING COSTS

9.1 In order to regulate the impact of Prudential Borrowing on the net revenue budget, Members approved a local policy to cap capital financing charges as a proportion of the annual Net Revenue Budget. This cap was set at 10% in 2018/19 which accommodates existing Capital Plan requirements and will act as a regulator if Members are considering expanding the Capital Plan using Prudential Borrowing. Members do have the option to review the cap in the context of its explicit impact on the Revenue Budget/Medium Term Financial Strategy.

10.0 REVIEW OF LONG TERM DEBT AND DEBT RESCHEDULING

10.1 The long term debt of the County Council is under continuous review.

10.2 The rescheduling of debt involves the early repayment of existing debt and its replacement with new borrowing. This can result in one-off costs or benefits called, respectively, premiums and discounts. These occur where the rate of the loan repaid varies from comparative current rates. Where the interest rate of the loan to be repaid is higher than the current rates, a premium is charged by the PWLB for repayment. Where the interest rate of the loan to be repaid is lower than the current rate, a discount on repayment is paid by the PWLB.

10.3 Discussions with the County Council's Treasury Management Advisor about the long term financing strategy are ongoing and any debt rescheduling opportunity will be fully explored.

10.4 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which was compounded in October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration has to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

10.5 As short term borrowing rates are expected to be considerably cheaper than longer term rates throughout 2018/19, 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), their short term nature and the likely costs of refinancing those short term loans once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

10.6 Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances by repaying debt prematurely as short term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in light of the debt repayment premiums.

10.7 The reasons for undertaking any rescheduling will include:

(a) the generation of cash savings at minimum risk;

(b) in order to help fulfil the Borrowing Strategy, and;

(c) in order to enhance the balance of the long term portfolio (ie amend the maturity profile and/or the balance of volatility).

11.0 MINIMUM REVENUE PROVISION (MRP) POLICY 2018/19

11.1 The statutory requirement for local authorities to charge the Revenue Account each year with a specific sum for debt repayment was replaced in February 2008 with more flexible statutory guidance which came into effect from 2008/09.

11.2 The new, and simpler, statutory duty (Statutory Instrument 2008) is that a local authority shall determine for the financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This replaces the previous prescriptive requirement that the minimum sum should be 4% of the Capital Financing Requirement (CFR); the CFR consists of external debt plus capital expenditure financed by borrowing from internal sources (surplus cash balances).

11.3 To support the statutory duty the Government also issued fresh guidance in February 2008 which requires that a Statement on the County 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 County Council are therefore legally obliged to have regard to this MRP guidance in the same way as applies to other statutory guidance such as the CIPFA Prudential Code, the CIPFA Treasury Management Code and the DCLG guidance on Investments.

11.4 The MRP guidance offers four options under which MRP might be made, with an overriding recommendation that the County Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the asset created by the capital expenditure is estimated to provide benefits (ie estimated useful life of the asset being financed). The previous system of 4% MRP did not necessarily provide that link.

11.5 The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this Annual Treasury Management Strategy.

11.6 The move to International Financial Reporting Standards (IFRS) from 2010/11 involves Private Finance Initiative (PFI) contracts and some leases (being reclassified as finance leases instead of operating leases) coming onto Local Authority Balance Sheets as long term liabilities. This accounting treatment impacts on the CFR, with the result that an annual MRP provision is required for PFI contracts and certain leases. To ensure that this change has no overall financial impact on local authority budgets, the Government updated their "Statutory MRP Guidance" with effect from 31 March 2010. This updated Guidance allows MRP to be equivalent to the existing lease rental payments and "capital repayment element" of annual payments to PFI Operators and the implications of this are reflected in the County Council's MRP policy for 2017/18.

11.7 The 'Statutory MRP Guidance' was again updated from 1 April 2012 but the amendments relate only to those authorities with responsibility for housing. MRP guidance remained the same for all other authorities.

11.8 The County Council's MRP policy is based on the Government's Statutory Guidance and following a review of this policy, no changes are proposed at this time. However, a further review of the existing assumptions for prudent provision incorporated into the County Council's MRP Policy will be undertaken as part of the 2018/19 budget review and any changes will be reported to Members as part of an in-year update of this Annual Treasury Management Strategy. Until that time, the policy for 2018/19 remains as follows:-

(a) for all **capital expenditure incurred before 1 April 2008**, MRP will be based on 4% of the Capital Financing Requirement (CFR) at that date. This will include expenditure supported by Government borrowing approvals and locally agreed Prudential Borrowing up to 31 March 2008. This is in effect a continuation of the old MRP regulations for all capital expenditure up to 31 March 2008 that has been financed from borrowing;

(b) for **capital expenditure incurred after 1 April 2008 which is supported by Government Borrowing approvals**, MRP to be based on 4% of such sums as reflected in subsequent CFR updates. This reflected the principle that the Revenue Support Grant (RSG) formula for supported borrowing approvals would still be calculated on this basis. It should be noted however that as part of the 2011/12 Local Government Finance Settlement, no supported borrowing approvals have been issued for the period after 2010/11 and the RSG formula was frozen as part of the 2013/14 introduction of retained local Business Rates;

(c) for **locally agreed Prudential Borrowing on capital expenditure incurred after 1 April 2008**, MRP will be calculated based on equal annual instalments over the estimated useful life of the asset for which the borrowing is undertaken. This method is a simpler alternative to depreciation accounting.

In view of the variety of different types of capital expenditure incurred by the County Council, which is not in all cases capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure, and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The estimated life of relevant assets will be assessed each year based on types of capital expenditure incurred but in general will be 25 years for buildings, 50 years for land, and 5 to 7 years for vehicles, plant and equipment. To the extent that the expenditure does not create a physical asset (eg capital grants and loans), and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the County Council.

In the case of long term debtors from loans, the amounts paid out are classed as capital expenditure for capital financing purposes. The expenditure is therefore included in the calculation of the County Council's Capital Financing Requirement. When the County Council receives the repayment of an amount loaned, the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the Capital Financing Requirement, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the eventual receipt is expected to fall short of the amount expended).

Where expenditure is incurred to acquire and/or develop properties for resale, the Capital Financing Requirement will increase by the amount expended. Where the County Council will subsequently recoup the amount expended via the sale of an asset, the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the Capital Financing Requirement, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the fair value of the properties falls below the amount expended).

Where expenditure is incurred to acquire properties meeting the accounting definition of investment properties, the Capital Financing Requirement will increase by the amount expended. Where the Council will subsequently recoup the amount expended (e.g. via the sale of an asset), the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the Capital Financing Requirement, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the fair value of the properties falls below the amount expended).

This approach also allows the County Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy.

(d) for **"on balance sheet" PFI schemes**, MRP will be equivalent to the "capital repayment element" of the annual service charge payable to the PFI Operator and for **finance leases**, MRP will be equivalent to the annual rental payable under the lease agreement.

11.9 Therefore the County Council's total MRP provision will be the sum of (a) + (b) + (c) + (d) (as defined above) which is considered to satisfy the prudent provision requirement. Based on this policy, total MRP in 2018/19 will be about £12.1m (including PFI and finance leases).

12.0 ANNUAL INVESTMENT STRATEGY

Background

12.1 Under the Local Government Act 2003 the County Council is required to have regard to Government Guidance in respect of the investment of its cash funds. This Guidance was revised with effect from 1 April 2010. The Guidance leaves local authorities free to make their own investment decisions, subject to the fundamental requirement of an Annual Investment Strategy being approved by the County Council before the start of the financial year.

12.2 This Annual Investment Strategy must define the investments the County Council has approved for prudent management of its cash balances during the financial year under the headings of **specified investments** and **non specified investments**.

12.3 This Annual Investment Strategy therefore sets out

- revisions to the Annual Investment Strategy;

- the Investment Policy;
- the policy regarding loans to companies in which the County Council has an interest;
- specified and non specified investments;
- Creditworthiness Policy - security of capital and the use of credit ratings;
- the Investment Strategy to be followed for 2018/19;
- investment reports to members;
- investment of money borrowed in advance of need;
- investment (and Treasury Management) training;

Revisions to the Annual Investment Strategy

12.4 In addition to this updated **Investment Strategy,** which requires approval before the start of the financial year, a revised Strategy will be submitted to County Council for consideration and approval under the following circumstances:

(a) significant changes in the risk assessment of a significant proportion of the County Council's investments;

(b) any other significant development(s) that might impact on the County Council's investments and the existing strategy for managing those investments during 2018/19.

Investment Policy

12.5 The parameters of the Policy are as follows:

(a) the County Council will have regard to the Government's Guidance on Local Government Investments as revised with effect from 1 April 2010, and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes;

(b) the County Council's investment policy has two fundamental objectives;

- the security of capital (protecting the capital sum from loss); and then
- the liquidity of its investments (keeping the money readily available for expenditure when needed)

(c) the County Council will also aim to seek the highest return (yield) on its investments provided that proper levels of security and liquidity are achieved. The risk appetite of the County Council is low in order to give priority to the security of its investments;

(d) the borrowing of monies purely to invest or lend and make a return is unlawful and the County Council will not engage in such activity;

(e) investment instruments for use in the financial year listed under **specified** and **non-specified investment** categories; and

(f) counterparty limits will be set through the County Council's Treasury Management Practices Schedules.

Specified and non-specified Investments

12.6 Based on Government Guidance as updated from 1 April 2010.

(a) investment Instruments identified for use in the forthcoming financial year are listed in the Schedules attached to this Strategy under the **specified** and **non-specified** Investment categories;

(b) all **specified** Investments (see **Schedule A**) are defined by the Government as options with "relatively high security and high liquidity" requiring minimal reference in investment strategies. In this context, the County Council has defined Specified Investments as being sterling denominated, with maturities up to a maximum of 1 year meeting the minimum high credit quality;

(c) **Non-specified** investments (see **Schedule B**) attract a greater potential of risk. As a result, a maximum local limit of 20% of "core cash" funds available for investment has been set which can be held in aggregate in such investments;

(d) for both **specified** and **non-specified** investments, the attached Schedules indicate for each type of investment:-

- the investment category
- minimum credit criteria
- circumstances of use
- why use the investment and associated risks
- maximum % age of total investments
- maximum maturity period

(Non-Specified only)

(e) there are other instruments available as Specified and Non-Specified investments that are not currently included. Examples of such investments are:-

Specified Investments
- Commercial Paper
- Gilt funds and other Bond Funds
- Treasury Bills

Non-Specified Investments	- Sovereign Bond issues - Corporate Bonds - Floating Rate notes - Equities - Open Ended Investment Companies - Derivatives

A proposal to use any of these instruments would require detailed assessment and be subject to approval by Members as part of this Strategy. Under existing scrutiny arrangements, the County Council's Audit Committee will also look at any proposals to use the instruments referred to above.

Creditworthiness Policy – Security of Capital and the use of credit ratings

12.7 The financial markets have experienced a period of considerable turmoil since 2008 and as a result attention has been focused on credit standings of counterparties with whom the County Council can invest funds.

It is paramount that the County Council's money is managed in a way that balances risk with return, but with the overriding consideration being given to the security of the invested capital sum followed by the liquidity of the investment. The Approved Lending List will therefore reflect a prudent attitude towards organisations with whom funds may be deposited.

The rationale and purpose of distinguishing specified and non-specified investments is detailed above. Part of the definition for a Specified investment is that it is an investment made with a body which has been awarded a high credit rating with maturities of no longer than 365 days.

It is, therefore, necessary to define what the County Council considers to be a "high" credit rating in order to maintain the security of the invested capital sum.

The methodology and its application in practice will, therefore, be as follows:-

(a) the County Council will rely on credit ratings published by the three credit rating agencies (Fitch, Moody's and Standard & Poor's) to establish the credit quality (ability to meet financial commitments) of counterparties (to whom the County Council lends) and investment schemes. Each agency has its own credit rating components to complete their rating assessments. These are as follows:

Fitch Ratings

Long Term	-	generally cover maturities of over five years and acts as a measure of the capacity to service and repay debt obligations punctually. Ratings range from AAA (highest credit quality) to D (indicating an entity has defaulted on all of its financial obligations)
Short Term	-	cover obligations which have an original maturity not exceeding one year and place greater emphasis on the liquidity necessary to meet financial commitments. The ratings range from F1+ (the highest credit quality) to D

		(indicating an entity has defaulted on all of its financial obligations)

Moody's Ratings

Long Term	-	an opinion of the relative credit risk of obligations with an original maturity of one year or more. They reflect both the likelihood of a default on contractually promised payments and the expected financial loss suffered in the event of default. Ratings range from Aaa (highest quality, with minimal credit risk) to C (typically in default, with little prospect for recovery of principal or interest)
Short Term	-	an opinion of the likelihood of a default on contractually promised payments with an original maturity of 13 months or less. Ratings range from P-1 (a superior ability to repay short-term debt obligations) to P-3 (an acceptable ability to repay short-term obligations)

Standard & Poor's Ratings

Long Term	-	considers the likelihood of payment. Ratings range from AAA (best quality borrowers, reliable and stable) to D (has defaulted on obligations)
Short Term	-	generally assigned to those obligations considered short-term in the relevant market. Ratings range from A-1 (capacity to meet financial commitment is strong) to D (used upon the filing of a bankruptcy petition).

In addition, all three credit rating agencies produce a Sovereign Rating to select counterparties from only the most creditworthy countries. The ratings are the same as those used to measure long term credit.

(b) the County Council will review the "ratings watch" and "outlook" notices issued by all three credit rating agencies referred to above. An agency will issue a "watch", (notification of likely change), or "outlook", (notification of a possible longer term change), when it anticipates that a change to a credit rating may occur in the forthcoming 6 to 24 months. The "watch" or "outlook" could reflect either a positive (increase in credit rating), negative (decrease in credit rating) or developing (uncertain whether a rating may go up or down) outcome;

(c) no combination of ratings can be viewed as entirely fail safe and all credit ratings, watches and outlooks are monitored on a daily basis. This is achieved through the use of Link Asset Services creditworthiness service. This employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies. The credit ratings of counterparties are then supplemented with the following overlays;

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings

- sovereign ratings to select counterparties from only the most creditworthy countries

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 County Council to determine the duration for investments. The County Council will therefore use counterparties within the following durational bands:-

Colour	**Maximum Investment Duration**
Yellow	5 Years
Purple	2 Years
Orange	1 Year
Blue	1 Year (UK nationalised / semi nationalised banks only)
Red	6 Months
Green	100 Days
No Colour	No investment to be made

(d) given that a number of central banks/government have supported or are still supporting their banking industries in some way, the importance of the credit strength of the sovereign has become more important. The County Council will therefore also take into account the Sovereign Rating for the country in which an organisation is domiciled, for countries other than the UK (use of UK banks will not be limited). As a result, only an institution which is domiciled in a country with a minimum Sovereign Rating of AA- from Fitch or equivalent would be considered for inclusion on the County Council's Approved Lending List (subject to them meeting the criteria above). Organisations which are domiciled in a Country whose Sovereign Rating has fallen below the minimum criteria will be suspended, regardless of their own individual score/colour. The list of countries that currently qualify using this credit criteria are shown in **Schedule D**. This list will be amended should ratings change, in accordance with this policy;

(e) in order to reflect current market sentiment regarding the credit worthiness of an institution the County Council will also take into account current trends within the Credit Default Swap (CDS) Market. Since they are a traded instrument they reflect the market's current perception of an institution's credit quality, unlike credit ratings, which often focus on a longer term view. These trends will be monitored through the use of Link Asset Services creditworthiness service which compares the CDS Market position for each institution to the benchmark CDS Index. Should the deviation be great, then market sentiment suggests that there is a fear that an institution's credit quality will fall. Organisations with such deviations will be monitored and their standing reduced by one colour band as a precaution. Where the deviation is great, the organisation will be awarded 'no colour' until market sentiment improves. Where entities do not have an actively traded CDS spread, credit ratings are used in isolation;

(f) fully and part nationalised banks within the UK currently have credit ratings which are not as high as other institutions. This is the result of the banks having to have to accept external support from the UK Government However, due to this Central Government involvement, these institutions now effectively take on the credit worthiness of the Government itself (i.e. deposits made with them are effectively being made to the Government). This position is expected to take a number of years to unwind and would certainly not be done so without a considerable notice period. As a result, institutions which are significantly or fully owned by the UK Government will be assessed to have a high level of credit worthiness;

(g) all of the above will be monitored on a weekly basis through Link Asset Services creditworthiness service with additional information being received and monitored on a daily basis should credit ratings change and/or watch/outlook notices be issued. Sole reliance will not be placed on the information provided by Link Asset Services however. In addition the County Council will also use market data and information available from other sources such as the financial press and other agencies and organisations;

(h) in addition, the County Council will set maximum investment limits for each organisation which also reflect that institution's credit worthiness – the higher the credit quality, the greater the investment limit. These limits also reflect UK Government involvement (i.e. Government ownership or being part of the UK Government guarantee of liquidity). These limits are as follows:-

Maximum Investment Limit	**Criteria**
£75m	UK "Nationalised / Part Nationalised" banks / UK banks with UK Central Government involvement
£20m to £60m	UK "Clearing Banks" and selected UK based Banks and Building Societies
£20m or £40m	High quality foreign banks

(i) should a score/colour awarded to a counterparty or investment scheme be amended during the year due to rating changes, market sentiment etc., the County Council will take the following action:-

- reduce or increase the maximum investment term for an organisation dependent on the revised score / colour awarded
- temporarily suspend the organisation from the Approved Lending List should their score fall outside boundary limits and not be awarded a colour
- seek to withdraw an investment as soon as possible, within the terms and conditions of the investment made, should an organisation be suspended from the Approved Lending List
- ensure all investments remain as liquid as possible, i.e. on instant access until sentiment improves.

(j) if a counterparty / investment scheme, not currently included on the Approved Lending List is subsequently upgraded, (resulting in a score which would fulfil the

County Council’s minimum criteria), the Corporate Director – Strategic Resources has the delegated authority to include it on the County Council’s Approved Lending List with immediate effect;

(k) a copy of the current Approved Lending List, showing maximum investment and time limits is attached at **Schedule C**. The Approved Lending List will be monitored on an ongoing daily basis and changes made as appropriate. Given current market conditions, there continues to be a very limited number of organisations which fulfil the criteria for non specified investments. This situation will be monitored on an ongoing basis with additional organisations added as appropriate with the approval of the Corporate Director – Strategic Resources.

The Investment Strategy to be followed for 2018/19

12.8 Recognising the categories of investment available and the rating criteria detailed above

(a) the County Council currently manages all its cash balances internally;

(b) ongoing discussions are held with the County Council's Treasury Management Advisor on whether to consider the appointment of an external fund manager(s) or continue investing in-house – any decision to appoint an external fund manager will be subject to Member approval;

(c) the County Council’s cash balances consist of two basic elements. The first element is **cash flow derived** (debtors/creditors/timing of income compared to expenditure profile). The second, **core element**, relates to specific funds (reserves, provisions, balances, capital receipts, funds held on behalf of other organisations etc.);

(d) having given due consideration to the County Council’s estimated level of funds and balances over the next three financial years, the need for liquidity and day to day cash flow requirements it is forecast that a maximum of £40m of the overall balances can be prudently committed to longer term investments (e.g. between 1 and 5 years);

(e) investments will accordingly be made with reference to this core element and the County Council’s ongoing cash flow requirements (which may change over time) and the outlook for short term interest rates (i.e. rates for investments up to 12 months);

(f) the County Council currently two one non-specified investment over 365 days;

(g) bank rate increased to 0.50% in November and underpins investment returns. Investment returns are expected to rise gently over the next 3 years;

The County Council will, therefore, avoid locking into long term deals while investment rates continue to be at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within a ‘low risk’ parameter. No trigger rates will be set for longer term deposits (two or three years) but this position will be kept under constant review and discussed with the Treasury Management Advisor on a regular basis.

(h) for its cash flow generated balances the County Council will seek to utilise 'business reserve accounts' (deposits with certain banks and building societies), 15, 30 and 100 day accounts and short dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Investment Reports to Members

12.9 Reporting to Members on investment matters will be as follows:

(a) in-year investment reports will be submitted to the Executive as part of the Quarterly Performance and Budget Monitoring reports;

(b) at the end of the financial year a comprehensive report on the County Council's investment activity will be submitted to the Executive as part of the Annual Treasury Management Outturn report;

(c) periodic meetings between the Corporate Director – Strategic Resources, the Corporate Affairs portfolio holder and the Chairman of the Audit Committee provide an opportunity to consider and discuss issues arising from the day to day management of Treasury Management activities.

Investment of Money Borrowed in Advance of Need

12.10 The Borrowing Policy covers the County Council's policy on Borrowing in Advance of Spending Needs.

Although the County Council has not borrowed in advance of need to date and has no current plans to do so in the immediate future, any such future borrowing would impact on investment levels for the period between borrowing and capital spending.

Any such investments would, therefore, be made within the constraints of the County Council's current Annual Investment Strategy, together with a maximum investment period related to when expenditure was expected to be incurred.

Treasury Management Training

12.11 The training needs of the County Council's staff involved in investment management are monitored, reviewed and addressed on an on-going basis and are discussed as part of the staff appraisal process. In practice most training needs are addressed through attendance at courses and seminars provided by CIPFA, the LGA and others on a regular ongoing basis.

The CIPFA Code also requires that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny (i.e. the Audit Committee). Training for Members and officers will be provided as required. The training arrangements for officers will also be available to Members.

13.0 OTHER TREASURY MANAGEMENT ISSUES

Policy on the use of External Treasury Management Service Providers

13.1 The County Council uses Link Asset Services – Treasury Solutions as its external treasury management adviser. Link provide a source of contemporary information, advice and assistance over a wide range of Treasury Management areas but particularly in relation to investments and debt administration.

13.2 Whilst the County Council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources, it fully accepts that responsibility for Treasury Management decisions remains with the authority at all times and will ensure that undue reliance is not placed upon advice of the external service provider.

13.3 Following a quotation exercise, Link Asset Services were appointed in September 2015 as a single provider of Treasury Management consultancy services for both the County Council and Selby District Council. The appointment is for three years, with the option for a further two year extension. The value and quality of services being provided are monitored and reviewed on an ongoing basis.

The scheme of delegation and role of the section 151 officer in relation to Treasury Management

13.4 The Government's Investment Guidance requires that a local authority includes details of the Treasury Management schemes of delegation and the role of the Section 151 officer in the Annual Treasury Management/Investment Strategy.

13.5 The key elements of delegation in relation to Treasury Management are set out in the following Financial Procedure Rules (FPR):-

(a) **14.1** The Council adopts CIPFA's "Treasury Management in the Public Services Code of Practice 2011" (as amended) as described in Section 5 of the Code, and will have regard to the associated guidance notes;

(b) **14.2** The County Council will create and maintain as the cornerstone for effective Treasury Management

(i) a strategic Treasury Management Policy Statement (TMPS) stating the County Council's policies, objectives and approach to risk management of its treasury management activities;

(ii) a framework of suitable Treasury Management Practices (TMPs) setting out the manner in which the County Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities. The Code recommends 12 TMPs;

(c) **14.3** The Executive and the full Council will receive reports on its Treasury Management policies, practices and activities including, as a minimum an Annual Treasury Management and Investment Strategy and associated report on Prudential Indicators in advance of the financial year;

(d) **14.4** The County Council delegates responsibility for the implementation and regular monitoring of its Treasury Management policies and practices to the Executive, and for the execution and administration of Treasury Management decisions to the Corporate Director – Strategic Resources (CD-SR), who will act in accordance with the Council's TMPs, as well as CIPFA's Standard of Professional Practice on Treasury Management;

(e) **14.5** The Executive will receive from the CD-SR a quarterly report on Treasury Management as part of the Quarterly Performance Monitoring report and an annual report on both Treasury Management and Prudential Indicators setting out full details of activities and performance during the preceding financial year;

(f) **14.6** The CD-SR will meet periodically with the portfolio holder for financial services, including assets, IT and procurement and such other Member of the Executive as the Executive shall decide to consider issues arising from the day to day Treasury Management activities;

(g) **14.7** The Audit Committee shall be responsible for ensuring effective scrutiny of the Treasury Management process;

(h) **14.8** The CD-SR shall periodically review the Treasury Management Policy Statement and associated documentation and report to the Executive on any necessary changes, and the Executive shall make recommendations accordingly to the County Council;

(i) **14.9** All money in the possession of the Council shall be under the control of the officer designated for the purposes of Section 151 of the Local Government Act 1972 (i.e. the Corporate Director - Strategic Resources).

13.6 In terms of the Treasury Management role of the Section 151 officer (the Corporate Director – Strategic Resources), the key areas of delegated responsibility are as follows

- recommending clauses, treasury management policies and practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports to Members
- submitting budgets and budget variations to Members
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers

Other Issues

13.7 The County Council continues to monitor potential PFI opportunities and assess other innovative methods of funding and the Corporate Director – Strategic Resources will report any developments to Executive at the first opportunity.

14.0 ARRANGEMENTS FOR MONITORING / REPORTING TO MEMBERS

14.1 Taking into account the matters referred to in this Strategy, the monitoring and reporting arrangements in place relating to Treasury Management activities are now as follows:

(a) an annual report to Executive and County Council as part of the Budget process that sets out the County Council's **Treasury Management Strategy and Policy** for the forthcoming financial year;

(b) an annual report to Executive and County Council as part of the Budget process that sets the various **Prudential Indicators**, together with a mid year update of these indicators as part of the Q1 Performance Monitoring report submitted to the Executive;

(c) **annual outturn reports** to the Executive for both Treasury Management and Prudential Indicators setting out full details of activities and performance during the preceding financial year.

(d) a quarterly report on Treasury Matters to Executive as part of the **Quarterly Performance and Budget Monitoring** report;

(e) **periodic meetings** between the Corporate Director – Strategic Resources, the Corporate Affairs portfolio holder and the Chairman of the Audit Committee to discuss issues arising from the day to day management of Treasury Management activities;

(f) copies of the reports mentioned in (a) to (d) above are provided to the **Audit Committee** who are also consulted on any proposed changes to the County Council's Treasury Management activities.

GARY FIELDING
Corporate Director – Strategic Resources
30 January 2018

NORTH YORKSHIRE COUNTY COUNCIL ANNUAL INVESTMENT STRATEGY 2018/19 – SPECIFIED INVESTMENTS

Investment	Security / Minimum Credit Rating	Circumstances of Use
Term Deposits with the UK Government or with UK Local Authorities (as per Local Government Act 2003) with maturities up to 1 year	High security as backed by UK Government	In-house
Term Deposits with credit rated deposit takers (Banks and Building Societies), including callable deposits with maturities less than 1 year	Organisations assessed as having "high credit quality" plus a minimum Sovereign rating of AA- for the country in which the organisation is domiciled	In-house
Certificate of Deposits issued by credit rated deposit takers (Banks and Building Societies) up to 1 year		Fund Manager or In-house "buy and hold" after consultation with Treasury Management Advisor
Forward deals with credit rated Banks and Building Societies less than 1 year (i.e. negotiated deal plus period of deposit)		In-house
Money Market Funds i.e. collective investment scheme as defined in SI2004 No 534 (*These funds have no maturity date*)	Funds must be AAA rated	In-house After consultation with Treasury Management Advisor Limited to £20m
Gilts (with maturities of up to 1 year)	Government Backed	Fund Manager or In-house buy and hold after consultation with Treasury Management Advisor
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in SI 2004 No 534) with maturities under 12 months (*Custodial arrangements required prior to purchase*)	Government Backed	After consultation with Treasury Management Advisor

SCHEDULE B

NORTH YORKSHIRE COUNTY COUNCIL ANNUAL INVESTMENT STRATEGY 2018/19 – NON-SPECIFIED INVESTMENTS

investment	A) Why use it? B) Associated Risks?	Security / Minimum Credit Rating	Circumstances of Use	Max % of overall investments or cash limits in cash category	Maximum investment with any one counterparty	Maximum Maturity Period
Term Deposit with credit rated deposit takers (Banks & Building Societies), UK Government and other Local Authorities with maturities greater than 1 year	A) Certainty of return over period invested which could be useful for budget purposes B) Not Liquid, cannot be traded or repaid prior to maturity Return will be lower if interest rates rise after making deposit Credit risk as potential for greater deterioration of credit quality over a longer period	Organisations assessed as having "high credit quality" Plus Where non UK domiciled - A minimum Sovereign rating of AA- for the country in which an organisation is domiciled	In-house	100% of agreed maximum proportion (20%) of core cash funds that can be invested for more than 1 year (estimated £20m)	£5m	2 years subject to potential future review with a maximum of no longer than 5 years
Certificate of Deposit with credit rated deposit takers (Banks & Building Societies) with maturities greater than 1 year *Custodial arrangements prior to purchase*	A) Attractive rates of return over period invested and in theory tradable B) Interest rate risk; the yield is subject to movement during life of CD which could negatively impact on its price		Fund Manager or In-house "buy & hold" after consultation with Treasury Management Advisor	25% of agreed proportion (20%) of core cash funds that can be invested for more than 1 year (£5m)	£3m	

investment	A) Why use it? B) Associated Risks?	Security / Minimum Credit Rating	Circumstances of Use	Max % of overall investments or cash limits in cash category	Maximum investment with any one counterparty	Maximum Maturity Period
Callable Deposits with credit rated deposit takers (Banks & Building Societies) with maturities greater than 1 year	A) Enhanced Income – potentially higher return than using a term deposit with a similar maturity B) Not liquid – only borrower has the right to pay back the deposit; the lender does not have a similar call Period over which the investment will actually be held is not known at outset Interest rate risk; borrower will not pay back deposit if interest rates rise after the deposit is made	Organisations assessed as having "high credit quality" Plus Where non UK domiciled - A minimum Sovereign rating of AA- for the country in which an organisation is domiciled	To be used in-house after consultation with Treasury Management Advisor	50% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£12.5m)	£5m	2 years subject to potential future review with a maximum of no longer than 5 years
Forward Deposits with a credit rated Bank or Building Society > 1 year (i.e. negotiated deal period plus period of deposit)	A) Known rate of return over the period the monies are invested – aids forward planning B) Credit risk is over the whole period, not just when monies are invested Cannot renege on making the investment if credit quality falls or interest rates rise in the interim period	Organisations assessed as having "high credit quality" Plus A minimum Sovereign rating of AA- for the country in which an organisation is domiciled	To be used in-house after consultation with the Treasury Management Advisor	25% of greed proportion (20%) of core cash funds that can be invested for more than 1 year (£5m)	£3m	2 years subject to potential future review with a maximum of no longer than 5 years

investment	A) Why use it? B) Associated Risks?	Security / Minimum Credit Rating	Circumstances of Use	Max % of overall investments or cash limits in cash category	Maximum investment with any one counterparty	Maximum Maturity Period
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in SI2004 No534) with maturities in excess of 1 year Custodial arrangements required prior to purchase	A) Excellent credit quality Relatively Liquid If held to maturity, yield is known in advance Enhanced rate in comparisons to gilts B) Interest rate risk; yield subject to movement during life off bond which could impact on price	AA or Government backed	In-house on a "buy and hold" basis after consultation with Treasury Management Advisor or use by Fund Managers	25% of greed proportion (20%) of core cash funds that can be invested for more than 1 year (£5m)	n/a	2 years subject to potential future review with a maximum of no longer than 5 years
Bonds issued by Multilateral development banks (as defined in SI2004 No534) with maturities in excess of 1 year Custodial arrangements required prior to purchase	A) Excellent credit quality Relatively Liquid If held to maturity, yield is known in advance Enhanced rate in comparison to gilts B) Interest rate risk; yield subject to movement during life off bond which could negatively impact on price				£3m	

investment	A) Why use it? B) Associated Risks?	Security / Minimum Credit Rating	Circumstances of Use	Max % of overall investments or cash limits in cash category	Maximum investment with any one counterparty	Maximum Maturity Period
UK Government Gilts with maturities in excess of 1 year Custodial arrangements required prior to purchase	A) Excellent credit quality Liquid - If held to maturity, yield is known in advance Liquid - If traded, potential for capital appreciation B) Interest rate risk; yield subject to movement during life if the bond which could impact on price	Government backed	Fund Manager	25% of greed proportion (20%) of core cash funds that can be invested for more than 1 year (£5m)	n/a	2 years subject to potential future review with a maximum of no longer than 5 years
Collateralised Deposit	A) Excellent credit quality B) Not liquid, cannot be traded or repaid prior to maturity Credit risk as potential for greater deterioration of credit quality over a longer period	Backed by collateral of AAA rated Local Authority LOBO's	In-house via money market broker or direct	100% of agreed proportion (20%) of core cash funds that can be invested for more than 1 year (£20m)	£5m	
Property Funds	A) Attractive rates of return over period invested and in theory very liquid B) Period over which the investment will actually be held is not known at outset Credit risk as potential for greater deterioration of credit quality over a longer period	Organisations assessed as having "high credit quality"	To be used in-house after consultation with the Treasury Management Advisor	100% of agreed proportion (20%) of core cash funds that can be invested for more than 1 year (£20m)	£5m	5 years subject to potential future review with a maximum of 10 years

SCHEUDLE C

APPROVED LENDING LIST 2018/19

Maximum sum invested at any time (The overall total exposure figure covers both Specified and Non-Specified investments)

	Country	Specified Investments (up to 1 year)		Non-Specified Investments (> 1 year £20m limit)	
		Total Exposure £m	Time Limit *	Total Exposure £m	Time Limit *
UK "Nationalised" banks / UK banks with UK Central Government involvement					
Royal Bank of Scotland	GBR	75.0	364 days	-	-
Natwest Bank	GBR				
UK "Clearing Banks", other UK based banks and Building Societies					
Santander UK plc (includes Cater Allen)	GBR	40.0	6 months	-	-
Barclays Bank	GBR	75.0	6 months	-	-
Bank of Scotland	GBR	75.0	6 months	-	-
Lloyds	GBR				
HSBC	GBR	30.0	364 days		
Goldman Sachs International Bank	GBR	40.0	6 months		
Standard Chartered Bank	GBR	40.0	6 months	-	-
Nationwide Building Society	GBR	40.0	6 months	-	-
Leeds Building Society	GBR	20.0	6 months	-	-
High quality Foreign Banks					
National Australia Bank	AUS	20.0	364 days	-	-
Commonwealth Bank of Australia	AUS	20.0	364 days		
Canadian Imperial Bank of Commerce	CAN	20.0	364 days	-	-
Deutsche Bank	DEU	20.0	Temporarily suspended	-	-
Credit Industriel et Commercial	FRA	20.0	6 months	-	-
BNP Paribas Fortis	FRA	20.0	6 months	-	-
Nordea Bank AB	SWE	20.0	364 days	-	-
Svenska Handelsbanken	SWE	40.0	364 days	-	-
Local Authorities					
County / Unitary / Metropolitan / District Councils		20.0	364 days	5.0	2 years
Police / Fire Authorities		20.0	364 days	5.0	2 years
National Park Authorities		20.0	364 days	5.0	2 years
Other Deposit Takers					
Money Market Funds		20.0	364 days	5.0	2 years
UK Debt Management Account		100.0	364 days	5.0	2 years

* Based on data as 31 December 2017

SCHEDULE D

APPROVED COUNTRIES FOR INVESTMENTS

Based on the lowest available rating

Sovereign Rating	Country
AAA	Australia Canada Denmark Germany Luxemburg Netherlands Norway Singapore Sweden Switzerland
AA+	Finland Hong Kong USA
AA	Abu Dhabi (UAE) France UK
AA-	Belgium Qatar

APPENDIX C

NORTH YORKSHIRE COUNTY COUNCIL

CAPITAL STRATEGY

1.0 BACKGROUND

1.1 The purpose of the Capital Strategy is to demonstrate that the Council takes capital expenditure and investment decisions in line with corporate and service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.2 The Capital Strategy comprises a number of distinct, but inter-related, elements as follows:

(a) Capital Expenditure (Section 2)

This section includes an overview of the governance process for approval and monitoring of capital expenditure, including the Council's policies on capitalisation, and an overview of its capital expenditure and financing plans.

(b) Capital Financing and Borrowing (Section 3)

This section provides a projection of the Council's capital financing requirement, how this impacted by capital expenditure decisions and how it will be funded and repaid. It therefore sets out the Council's borrowing strategy and explains how it will discharge its duty to make prudent revenue provision for the repayment of debt.

(d) Alternative Investments (Section 4)

This section provides an overview of those of the Council's current and proposed alternative investment activities that count as capital expenditure, including processes, due diligence and defining the Council's risk appetite in respect of these.

(e) Chief Financial Officer's statement (Section 5)

This section contains the Chief Financial Officer's views on the deliverability, affordability and risk associated with the capital strategy

2.0 **CAPITAL EXPENDITURE**

Capitalisation Policy

2.1 Expenditure is classified as capital expenditure when it results in the acquisition or construction of an asset (e.g. land, buildings, roads and bridges, vehicles, plant and equipment etc.) that:

- Will be held for use in the delivery of services, for rental to others, investment or for administrative purposes; and

- Are of continuing benefit to the Council for a period extending beyond one financial year.

Subsequent expenditure on existing assets is also classified as capital expenditure if these two criteria are met.

2.2 There may be instances where expenditure does not meet this definition but would be treated as capital expenditure, including:

- Where the Council has no direct future control or benefit from the resulting assets, but would treat the expenditure as capital if it did control or benefit from the resulting assets; and

- Where statutory regulations require the Council to capitalise expenditure that would not otherwise have expenditure implications according to accounting rules

2.3 The County Council operates de-minimis limits for capital expenditure. This means that items below these limits are charged to revenue rather than capital. The limits are currently as follows:

- **General Limit:** £20,000
- **Schools Limit:** £2,000

Governance

2.4 Capital expenditure is a necessary element in the development of the Council's services since it generates investment in new and improved assets. Capital expenditure is managed through the Capital Plan – a three year capital budget set annually as part of the budget setting process and reviewed quarterly as part of performance monitoring arrangements.

2.5 The County Council's Financial Procedure Rules and the Asset Management Planning Framework provide a framework for the preparation and appraisal of schemes proposed for inclusion in the Capital Plan, appropriate authorisations for individual schemes to proceed and facilitate the overall management of the Capital Plan within defined resource parameters.

2.6 The Corporate Director –Strategic Resources shall determine the format of the Capital Plan and the timing of reports relating to it. The approved Capital Plan will comprise a number of individual schemes each of which will be quantified in overall project terms or on an annualised basis, as appropriate. Each Director shall prepare a draft Capital Plan for their service, in consultation with the Corporate Director – Strategic Resources, for submission to the Executive. The Capital Plan should identify planned expenditure, and funding, at proposed individual scheme or programme level.

2.7 The Corporate Director – Strategic Resources is responsible for preparing an overall Capital Plan for consideration by the Executive, and approval by the Council, the funding of which shall be compatible at all times with the Treasury Management Policy Statement of the Council. Individual schemes shall only be included in the Capital Plan following a project appraisal process undertaken in accordance with the guidelines defined in the Asset Management Planning Framework and in accordance with the Property Procedure Rules.

Capital Expenditure and Funding Plans

2.7 The County Councils capital expenditure plans as per the Capital Plan are set out in **Appendix B Section 3.**

2.8 When expenditure is classified as capital expenditure for capital financing purposes, this means that the Council is able to finance that expenditure from any of the following sources:

(a) **Capital grants and contributions** - amounts awarded to the Council in return for past or future compliance with certain stipulations.

(b) **Capital receipts** – amounts generated from the sale of assets and from the repayment of capital loans, grants or other financial assistance.

(c) **Revenue contributions** – amounts set aside from the revenue budget in the Reserve for Future Capital Funding.

(d) **Borrowing** - amounts that the Council does not need to fund immediately from cash resources, but instead charges to the revenue budget over a number of years into the future.

2.9 The implications of financing capital expenditure from 'borrowing' are explained in section 3 below.

3.0 CAPITAL FINANCING REQUIREMENT AND BORROWING

Context

3.1 The County Council is required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (referred to as the 'Prudential Code') when assessing the affordability, prudence and sustainability of its capital investment plans.

3.2 Fundamental to the prudential framework is a requirement to set a series of prudential indicators. These indicators are intended to collectively build a picture that demonstrates the impact over time of the Council's capital expenditure plans upon the revenue budget and upon borrowing and investment levels, and explain the overall controls that will ensure that the activity remains affordable, prudent and sustainable.

3.3 A summary of the actual prudential indicators for 2016/17, and the estimates for 2017/18 through to 2020/21, are provided in **Appendix B Section 11**.

Capital Financing Requirement

3.4 When capital expenditure is funded from borrowing, this does not result in expenditure being funded immediately from cash resources, but is instead charged to the revenue budget over a number of years. It does this in accordance with its policy for the repayment of debt, which is set out in **Appendix B Section 11.**

3.5 The forward projections of the CFR reflect:

- Additional capital expenditure from borrowing or further credit arrangements resulting in an increase to the CFR and

- Revenue budget provision being made for the repayment of debt, which results in a reduction to the CFR).

3.6 The actual CFR for 2016/17 and forward projections for the current and forthcoming years are as follows:

Item	2016/17 Actual £m	2017/18 Probable £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Capital Borrowing	322.0	307.0	295.3	283.4	272.3
Other Long Term Liabilities	5.3	5.1	4.7	4.4	4.0
Total Capital Financing Requirement	327.3	312.1	300.0	287.8	276.3

3.7 The forecast reduction in the CFR is a result of the annual provision for the repayment of debt each year being in excess of the amount of capital expenditure that it is intended to finance from borrowing based on the current capital programme up to 2020/21.

3.8 The CFR may potentially increase dependent on the level of capital investment undertaken. Currently, the Capital Plan does not include expenditure relating to alternative investments (other than loans to Limited Companies). As alternative investment plans are developed and approved the Capital Plan will be updated which may potentially impact on the Capital Financing Requirement.

External Borrowing Limits

3.9 The Council is only permitted to borrow externally (including via credit arrangements) up to the level implied by its Capital Financing Requirement (CFR). To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised limit** – this defines the maximum amount of external debt permitted by the Council, and represents the statutory limit determined under section 3 (1) of the Local Government Act 2003.

- **Operational boundary** – this is an estimate of the probable level of the Council's external debt, and provides the means by which external debt is managed to ensure that the 'authorised limit' is not breached.

3.10 The proposed limits, which are set out in **Appendix B Section 3**, make separate provision for external borrowing and other long-term liabilities, and are based upon an estimate of the most likely but not worst case scenarios. They allow sufficient headroom for fluctuations in the level of cash balances and in the level of the CFR.

3.11 Alternative investment activities are likely to be classed as capital expenditure. The Alternative Investments Strategy is still evolving though and, in the event that major initiatives are proposed, in excess of those already in the Capital Programme, it may be necessary to review the current borrowing limits.

3.12 The agreed **Operational Boundary** and **Authorised Limits** for external debt are as follows:

Item	2017/18 probable £m	2018/19 estimate £m	2019/20 estimate £m	2020/21 estimate £m
Debt outstanding at start of year	309.0	313.4	301.7	290.7
+ **External borrowing requirements**				
Capital borrowing requirement	7.6	0.4	-0.1	0.2
Replacement borrowing	21.4	2.5	22.0	27.1
MRP charged to Revenue	-22.6	-12.1	-11.8	-11.3
Borrowing b/fwd from 2016/17	13.0	-	-	-
Internally funded variations	6.5	0.0	0.9	16.1
Sub-total	25.9	-9.2	10.9	32.1
- **External debt repayment**	-21.4	-2.5	-22.0	-27.1
= **Forecast Debt Outstanding**	**313.4**	**301.7**	**290.7**	**295.6**
+ **Other 'IFRS' long term liabilities**	5.1	4.7	4.4	4.0
= **Total Debt Outstanding**	**318.5**	**306.4**	**295.1**	**299.6**
+ **Provision for**				
Debt rescheduling	15.0	15.0	15.0	15.0
Potential capital receipts slippage	5.0	5.0	5.0	5.0
New borrowing taking place before principal repayments made	21.4	2.5	22.0	27.1
= **Operational Boundary for year**	**359.9**	**328.9**	**337.1**	**346.8**
+ **Provision for cash movements**	20.0	20.0	20.0	20.0
= **Authorised Limit for year**	**379.9**	**348.9**	**357.1**	**366.8**

Borrowing Strategy

3.13 The County Councils Borrowing Strategy is set out in **Appendix B Section 8**.

3.14 The County Council is currently maintaining an under borrowed position. This means the Capital Financing Requirement (CFR) has not been fully funded from long-term external borrowing as cash supporting the authority's reserves and balances has been used as a short term measure.

3.15 The use of internal borrowing has been an effective strategy in recent years as:

- It has enabled the Council to avoid significant external borrowing costs; and
- It has mitigated significantly the risks associated with investing cash in what has often been a volatile and challenging market.

The internal borrowing position will be carefully reviewed and monitored on an ongoing basis in order to consider any changes to borrowing rates as well as current and future cash flow constraints.

3.16 Further long term external borrowing may be undertaken, in excess of the current forecasts, in the event that it is not possible or desirable to sustain the anticipated internal borrowing position.

3.17 The external borrowing requirement will be kept under review, and long term external loans will be secured within the parameters established by the authorised limit and operational boundary for external debt (as set out within **Annex B**).

3.18 Opportunities to generate savings by refinancing or prematurely repaying existing long term debt will also be kept under review. Potential savings will be considered in the light of the current treasury position and the costs associated with such actions.

Minimum Revenue Provision

3.19 The County Council sets cash resources aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as the minimum revenue provision (MRP) for the repayment of debt.

3.20 The Capital Financing Requirement (CFR) provides a measure of the amount of capital expenditure which has been financed from borrowing that the Council yet to fund from cash resources.

3.21 Statutory guidance requires MRP to be provided annually on a prudent basis. In accordance with the requirement to make a prudent 'revenue provision for the repayment of debt', the Council ensures that debt is repaid over a period that is commensurate with the period over which the capital expenditure provides benefit. This is achieved by applying the methodology set out in **Appendix B Section 11**. The revenue budget provision for MRP charges in 2018/19 has been compiled on a basis consistent with this policy.

4.0. ALTERNATIVE INVESTMENTS

Introduction

4.1 The prolonged low interest rate environment has resulted in reduced returns on treasury management investments. Moreover, the introduction of the general power of competence has given local authorities far more flexibility in the types of activity they can engage in. These changes in the economic and regulatory landscape, combined with significant financial challenges, have led many authorities to consider different and more innovative types of investment.

4.2 CIPFA recently issued an update to its Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (the Treasury Management Code). One of the main changes introduced by the new Code is to require authorities to incorporate all of the financial and non-financial assets held for financial return in authorities' annual capital strategies.

4.3 Separately, the Department for Communities and Local Government has recently consulted on changes to its statutory Guidance on Local Authority Investments. At the time of writing this strategy, the revised statutory guidance had not been issued, but it is expected that the guidance will reinforce the need for commercial investment activity to be included in the annual Capital Strategy.

4.4 In advance of confirmation of the statutory requirements related to commercial investment activities, the following paragraphs provide an overview of the Council's current approach to commercial investment activity. This section of the Capital Strategy will need to be updated once the revised statutory Guidance on Local Authority Investments is published and/or as the Council's own agenda for commercial investments evolves.

4.5 All alternative investment activities are subject to approval in accordance with the Council's governance framework for decision making.

Alternative Investment Objectives

4.6 The primary objectives of alternative investment activities are:

- Security – to protect the capital sums invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed.

The generation of yield is distinct from these prudential objectives. However, once proper levels of security and liquidity are determined, it is then reasonable to consider what yield can be obtained consistent with these priorities.

Non-core activities and investments are primarily undertaken by the Council in order to generate income to support the delivery of a balanced budget. Such investments are only entered following a full assessment of the risks and having secured expert external advice (i.e. where it is relevant to do so).

4.7 An overall maximum exposure of £50m for alternative investments was approved by Executive in August 2017.

Commercial Investment Board

4.8 Given the technical nature of potential alternative investments and strong linkages to the Council's Treasury Management function, appropriate governance and decision making arrangements are needed to ensure robust due diligence in order to make recommendations for implementation. As a result, a Commercial Investment Board has been established. All investments will be subject to consideration and where necessary recommendations of the Commercial Investment Board.

4.9 The Board is not be a constituted body and therefore does not have formal decision making powers. However, it is the chief means of identifying, reviewing and recommending schemes for investment decisions. Formal decisions on investments will be taken within the existing delegations namely through delegated authority to the Corporate Director, Strategic Resources and further decisions as made by the Executive.

4.10 The Board has delegated authority to approve individual investments up to a limit of £1m per investment and up to a total of £5m in any one financial year.

4.11 The responsibilities of the Board also include:

- To consider appropriate due diligence proportionate to the investment/risk/reward proposed.
- Terminate investments should concerns be raised - to consider and recommend cases for early termination of alternative investments.
- To monitor returns against approved performance targets.
- To report performance of alternative investments to the Executive on a quarterly basis
- To make recommendations to Executive on any proposed changes to the framework.

4.12 Membership of the Board is as follows:

- Lead Member for Finance (Chair)
- Lead Member for Growth
- Corporate Director Strategic Resources
- Corporate Director Business and Environmental Services
- Assistant Director Strategic Resources – LBP to CFO

- Assistant Director BES - Growth, Planning and Trading Standards

Investment Properties

4.13 Options are currently being considered for the acquisition of land and buildings for investment purposes, rather than for the supply of goods or services or for administrative purposes. Such assets will be classified as Investment Properties.

4.14 Investment properties will be measured at their fair value annually (which will ensure the valuation reflects the market conditions at the end of each reporting period). The fair value measurement will enable the County Council to assess whether the underlying assets provide security for capital investment. Where the fair value of the underlying assets is no longer sufficient to provide security against loss, mitigating actions will be considered, to ensure that appropriate action is taken to protect the capital sum invested.

4.15 The approach to the acquisition of an investment property portfolio is still being developed. An Investment Property Strategy is currently being formulated and will be considered by the Alternative Investment Board before being submitted to Executive for approval.

Loans to Third Parties

4.16 Loans to third parties will be considered, as part of a wider strategy for local economic growth, even though they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

4.17 Such loans will be considered when all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;

- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;

- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;

- A formal loan agreement is put in place which stipulates the loan period (*which will not exceed 25 years*), repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund, and takes appropriate account of state aid rules) and any other terms that will protect the Council from loss;

4.18 The County Council does not currently have in place any loans with third parties.

Loans to Limited Companies

4.19 The County Council has made a number of loans in recent years for policy reasons and will continue to monitor and review this position.

(a) the County Council's general investment powers under this Annual Treasury Management and Investment Strategy come from the Local Government Act 2003 (Section 12). Under this Act a local authority has the power to invest for any purpose relevant to its functions or for the purpose of the prudent management of its financial affairs;

(b) in addition to investment, the County Council has the power to provide loans and financial assistance to Limited Companies under the Localisation Act 2011 (and also formally under the general power of wellbeing in the Local Government Act 2000) which introduced a general power of competence for authorities;

(c) any such loans to limited companies will not be classed as investments made by the County Council. Instead they will be classed as capital expenditure and will be approved, financed and accounted for accordingly;

(d) at present the County Council has made several loans to companies in which it has an equity investment. In all cases loan limits are set, and reviewed periodically, by the Executive; and

4.20 The County Council has the following long term loans to its subsidiary in place as at 31 December 2017:

Subsidiary	Total Loan Agreed £m	Loan Advanced £m	Loan Term (Years)	Interest Rate %	Loan Balance £m
NYnet	10.00	Overdraft	N/A	3.0 + Base	0.60
Yorwaste – Loan 1	3.70	2017/18*	10	4.0 + Base	3.70
Yorwaste – Loan 2	3.85	2017/18	10	4.0 + Base	3.50
Brierley Homes	2.75	2017/18	2	4.0 + Base	0.12
First North Law	0.25	2017/18	10	4.0 + Base	0.04
Total	**20.55**				**7.96**

* Loan extension agreed 2017/18

Other Alternative Investments

4.20 At the time of writing this section of the Capital Strategy, other alternative investment activities are in the early stages of development. Consideration of individual investment opportunities will be subject to detailed business cases and subject to review and approval by the Alternative Investment Board and Executive. The Capital Strategy will be updated should further investment opportunities be developed during 2018/19 and/or in the event that the statutory Guidance on Local Authority Investments, when issued, requires further content to be included.

5.0 SECTION 151 OFFICER STATEMENT

Background

8.1 The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) plays a key role in capital finance in local authorities. Local authorities determine their own programmes for investment that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

8.2 In financing capital expenditure, local authorities are governed by legislative frameworks, including the requirement to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

8.3 In order to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability, the Prudential Code requires authorities to have in place a Capital Strategy that sets out the long term context in which capital expenditure and investment decisions are made, and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

8.4 The Prudential Code requires the Chief Financial Officer to report explicitly on the affordability and risk associated with the Capital Strategy. The following are specific responsibilities of the Section 151 Officer:

- recommending clauses, treasury management policy/practices for approval, reviewing regularly, and monitoring compliance;
- submitting quarterly treasury management reports;
- submitting quarterly capital budget reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money

- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority

- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing

- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources

- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees

- ensuring that members are adequately informed and understand the risk exposures taken on by an authority

- ensuring that the authority has adequate expertise, either in house or externally provided

- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed