# BOURNEMOUTH COUNCIL

# TREASURY MANAGEMENT STRATEGY STATEMENT 2017/18

## Introduction

### Background

1 The Council defines its treasury management activities as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks." Part of the treasury management operation is to ensure that the cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

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

### Reporting Requirements

3 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

4 **Prudential and treasury indicators and treasury strategy** - The first, and most important report covers:

a The capital plans (including prudential indicators);

b A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

c The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and

d An investment strategy (the parameters on how investments are to be managed).

5 **Quarterly treasury management report** – This will update members with the progress of the capital position, amending prudential indicators if necessary, and whether any policies require revision. The reports will be presented to the Audit and Governance Commitee.

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

7 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

**Treasury Management Strategy for 2017/18**

8 The strategy for 2017/18 covers two main areas:

**Capital issues**

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

**Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

**Training**

10 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. Training provided by Capita Asset Services will be organised for members during 2017/18.

11 The training needs of treasury management officers are periodically reviewed.

**Treasury management consultants**

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

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

14 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment

and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## The Capital Prudential Indicators 2017/18–2019/20

15 The Council's capital expenditure plans have a key influence over the treasury management activity. The capital expenditure plans are reflected in the prudential indicators, which are designed to assist members' in considering the impact and risk of this Council's capital expenditure plans.

### Capital expenditure

16 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

| Capital expenditure | 2015/16 Actual £'000 | 2016/17 Estimate £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 |
|---|---|---|---|---|---|
| Adult and Children | 15,785 | 15,485 | 2,731 | - | - |
| Environment and Economy | 21,838 | 31,483 | 32,610 | 17,002 | - |
| Corporate Services | 4,242 | 3,702 | - | - | - |
| **General Fund Total** | **41,865** | **50,670** | **35,341** | **17,002** | **-** |
| HRA | 10,510 | 16,212 | 18,362 | 11,666 | - |
| **Total** | **52,375** | **66,882** | **53,703** | **28,668** | **-** |

17 The tables below and on the following page summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

### General Fund Capital Expenditure

| Capital expenditure | 2015/16 Actual £'000 | 2016/17 Estimate £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 |
|---|---|---|---|---|---|
| **General Fund Total** | **41,865** | **50,670** | **35,341** | **17,002** | **-** |
| **Financed by:** | | | | | |
| Capital receipts | (1,320) | (2,060) | (7) | - | - |
| Capital grants & Contributions | (26,393) | (22,686) | (22,149) | (5,390) | - |
| Other Contributions | (2,347) | (2,622) | (595) | (2,350) | - |
| Reserve Contributions | (4,275) | (4,449) | (1,336) | (1,197) | - |
| Internal Borrowing | (7,530) | (18,853) | (11,254) | (8,065) | - |
| External Borrowing | - | - | - | - | - |
| **Total financing for the year** | **(41,865)** | **(50,670)** | **(35,341)** | **(17,002)** | **0** |

## HRA Capital Expenditure

| Capital expenditure | 2015/16 Actual £'000 | 2016/17 Estimate £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 |
|---|---|---|---|---|---|
| **HRA Total** | **10,510** | **16,212** | **18,362** | **11,666** | **-** |
| **Financed by:** | | | | | |
| Capital receipts | (488) | (1,936) | (949) | (32) | - |
| Major Repairs Allowance | (8,005) | (9,230) | (8,533) | (7,805) | - |
| Other Contributions | (42) | - | - | - | - |
| Reserve Contributions | (1,180) | (4,576) | (5,359) | (3,829) | - |
| Interal Borrowing | (795) | (470) | (3,521) | - | - |
| **Total financing for the year** | **(10,510)** | **(16,212)** | **(18,362)** | **(11,666)** | **0** |

## The Council’s borrowing need (the Capital Financing Requirement)

18 The second prudential indicator is the Council’s Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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

20 The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council’s borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

21 The Council is asked to approve the CFR projections below:

| | 2015/16 Actual £'000 | 2016/17* Estimate £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| CFR – general fund | 104,791 | 128,811 | 140,064 | 142,526 | 136,825 |
| CFR – housing | 68,281 | 63,583 | 67,104 | 67,104 | 67,104 |
| **Total CFR** | **173,072** | **192,394** | **207,168** | **209,630** | **203,929** |
| **Movement in CFR** | 4,311 | 19,322 | 14,774 | 2,462 | (5,701) |
| | | | | | |
| **Movement in CFR represented by** | | | | | |
| Net movement in borrowing for the year (above) | 8,325 | 19,323 | 14,775 | 8,065 | - |
| Less MRP/VRP and other financing movements | (4,014) | (1) | (1) | (5,603) | (5,701) |
| **Movement in CFR** | **4,311** | **19,322** | **14,774** | **2,462** | **(5,701)** |

*Transfer of HRA debt to General Fund due to PV panels

**Minimum Revenue Provision (MRP) policy statement**

22 The Council is required to make a Minimum Revenue Provision (MRP). It is a statutory requirement to make a charge to the Council's General Fund to make provision for the repayment of the Council's past capital debt and other credit liabilities.

23 The scheme of MRP was set out in former regulations 27, 28 and 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. This system was radically revised in 2008 by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which shifted the emphasis from regulations to guidance. The key principle of the new system and accompanying guidance is that an authority's debt liability should be repaid over a similar period to that which the asset associated with the capital expenditure provides benefits or, in the case of borrowing supported by RSG, in-line with the period implicit in the determination of that grant (i.e. 4% p.a.). Local authorities are asked by the Secretary of State "to prepare an annual statement of their policy on making MRP for submission to their full Council".

24 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be either:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1);
- **Based on CFR** – MRP will be based on the CFR (option 2);

25 These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

26 From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be either:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);
- **Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

27 The type of approach intended by the MRP guidance is clearly to enable local circumstances and discretion to play a part, as the guidance in general contains a set of recommendations rather than representing a prescriptive process. The guidance makes it clear that councils can follow an alternative approach, provided they still make a prudent provision.

28 Officers have reviewed the amounts of MRP and Voluntary Revenue Provision (VRP) provided from 2004/05 to 2015/16 and are seeking member approval to vary the basis of provision.

29 It is recommended that members approve the following MRP policy to be applied from 2016/17 onwards:

- In respect of all supported borrowing capital expenditure incurred prior to 2016/17 (excluding assets acquired under PFI or finance lease arrangements) MRP will be provided at a rate of 2% on a straight line basis to ensure the balance is fully cleared over the period in line with the useful life of the assets the debt services.
- In respect of all unsupported borrowing capital expenditure incurred prior to 2016/17 (excluding assets acquired under PFI or finance lease arrangements) the Council will apply the Asset life method as used in previous years and will apply an average life of 25 years for the unsupported borrowing requirement to be repaid over based on historical schemes that have required and applied unsupported borrowing
- MRP charges from 1 April 2004 to 31 March 2016 exceeded what prudence required during the period under this revised policy. There will be a realignment of MRP charged to the revenue account in 2016/17 and subsequent years to recognise this excess sum. Total MRP after applying realignment will not be less than zero in any financial year.
- In respect of capital expenditure incurred in 2016/17 and subsequent financial years MRP will be provided at a rate of 4% on the written down balance.

30 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

31 Repayments included in annual PFI or finance leases are applied as MRP.

## Borrowing

32 The capital expenditure plans set out in Appendix 3 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

### Current portfolio position

33 The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR),

highlighting any over or under borrowing.

| | 2015/16 Actual £'000 | 2016/17 Estimate £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 88,603 | 86,353 | 84,605 | 82,830 | 101,569 |
| Expected change in Debt | (2,250) | (1,748) | (1,775) | 18,739 | (751) |
| Other long-term liabilities (OLTL) | 10,434 | 10,052 | 9,669 | 9,256 | 8,812 |
| Expected change in OLTL | (382) | (383) | (413) | (444) | (478) |
| **Actual gross debt at 31 March** | **96,405** | **94,274** | **92,086** | **110,381** | **109,152** |
| **The Capital Financing Requirement** | **173,072** | **192,394** | **207,168** | **209,630** | **203,929** |
| **Under / (over) borrowing** | **76,667** | **98,120** | **115,082** | **99,249** | **94,777** |

34 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

35 The Chief Financial Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

**Treasury Indicators: limits to borrowing activity**

36 **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

37 **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

a This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Councils’ plans, or those of a specific Council, although this power has not yet been exercised.

b The Council is asked to approve the following authorised limit:

| | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m |
|---|---|---|---|---|
| External Debt | 94 | 92 | 110 | 109 |
| Operational boundary | 140 | 150 | 150 | 150 |
| Authorised limit | 190 | 200 | 200 | 200 |

c Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

| HRA Debt Limit | 2016/17 Estimate £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 |
|---|---|---|---|---|
| HRA debt cap | 69,000 | 69,000 | 69,000 | 69,000 |
| HRA CFR | 63,583 | 67,104 | 67,104 | 67,104 |
| HRA headroom | 5,417 | 1,896 | 1,896 | 1,896 |

### Prospects for interest rates

38 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their view on the base rate and PWLB borrowing costs.

| | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% | 0.50% | 0.75% | 0.75% |
| 5yr PWLB rate | 1.60% | 1.60% | 1.60% | 1.60% | 1.60% | 1.70% | 1.70% | 1.70% | 1.80% | 1.80% | 1.90% | 1.90% | 2.00% | 2.00% |
| 10yr PWLB rate | 2.30% | 2.30% | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.40% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% |
| 25yr PWLB rate | 2.90% | 2.90% | 2.90% | 2.90% | 3.00% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% |
| 50yr PWLB rate | 2.70% | 2.70% | 2.70% | 2.70% | 2.80% | 2.80% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% |

### Economic Background

39 **UK** GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

40 The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in

its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

41 The Chancellor has said he will do 'whatever is needed' i.e. to promote growth; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased, in the Autumn Statement on 23 November.

42 The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of 3.2% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, (16% down against the US dollar and 11% down against the Euro); this will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

43 What is clear is that consumer disposable income will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure for November surprised by under shooting forecasts at 1.2%. However, producer output prices rose at 2.1% and core inflation was up at 1.4%, confirming the likely future upwards path.

44 Gilt yields, and consequently PWLB rates, have risen sharply since

hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and have hit a peak on the way up again of 1.46% on 14 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

45 Employment has been growing steadily during 2016, despite initial expectations that the referendum would cause a fall in employment. However, the latest employment data in November, (for October), showed a distinct slowdown in the rate of employment growth and an increase in the rate of growth of the unemployment claimant count. House prices have been rising during 2016 at a modest pace but the pace of increase has been slowing since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

46 **USA**. The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, the first estimate for quarter 3 at 2.9% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which took place in December 2016. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis.

47 The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking

employment.

48 Trump's election has had a profound effect on the bond market and bond yields have risen sharply in the weeks since his election. Time will tell if this is a temporary over reaction, or a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

49 The election does not appear likely to have much impact on the Fed. in terms of holding back further on increasing the Fed. Rate. If the Trump package of policies is fully implemented, there is likely to be a significant increase in inflationary pressures which could, in turn, mean that the pace of further Fed. Rate increases will be quicker and stronger than had been previously expected.

50 In the first few weeks since the US election, there has been a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which is likely to be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

51 **EZ**. In the Eurozone, the ECB commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%.

52 EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.6% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central

banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

53 There are also significant specific political and other risks within the EZ: -

54 Greece continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.

55 The under capitalisation of Italian banks poses a major risk. Some German banks are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

**Borrowing strategy**

56 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow have been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

57 The Chief Financial Officer has the delegated responsibility to arrange such loans as are legally permitted to meet the Council's borrowing requirement and to arrange terms of all loans to the Council including amounts, periods and rates of interest.

58 Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

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

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

c Any decisions will be reported to Audit and Governance Commitee at the next available opportunity.

**Treasury Management Limits on activity**

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

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

b Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

c Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

| £m | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|
| **Interest rate exposures** | | | |
| | **Upper** | **Upper** | **Upper** |
| **Limits on fixed interest rates based on net debt** | 100% | 100% | 100% |
| **Limits on variable interest rates based on net debt** | 4% | 4% | 4% |
| **Limits on fixed interest rates for Investments** | 100% | 100% | 100% |
| **Limits on variable interest rates for Investments** | 50% | 50% | 50% |
| **Maturity structure of fixed interest rate borrowing 2017/18** | | | |
| | | **Lower** | **Upper** |
| Under 12 months | | 0% | 40% |
| 12 months to 2 years | | 0% | 50% |
| 2 years to 5 years | | 0% | 60% |
| 5 years to 10 years | | 0% | 80% |
| 10 years and above | | 50% | 100% |
| **Maturity structure of variable interest rate borrowing 2017/18** | | | |
| | | **Lower** | **Upper** |
| Under 12 months | | 0% | 100% |
| 12 months to 2 years | | 0% | 100% |
| 2 years to 5 years | | 0% | 100% |
| 5 years to 10 years | | 0% | 25% |
| 10 years and above | | 0% | 25% |

**Policy on borrowing in advance of need**

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

can ensure the security of such funds.

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

### Debt rescheduling

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

64 The reasons for any rescheduling to take place will include:

a The generation of cash savings and / or discounted cash flow savings;

b Helping to fulfil the treasury strategy;

c Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

### Municipal Bond Agency

66 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

## Annual Investment Strategy

### Investment Policy

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

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

69 Ratings will not be the sole determinant of the quality of an institution;

it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

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

**Creditworthiness policy**

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

a It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

b It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

72 The Chief Financial Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to which types of investment instruments that can be used as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

73 Credit rating information is supplied by Capita Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

74 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

**Sovereign Ratings**

- AAA (non UK)

*(Rating Description: AAA = Prime Rating, AA+, AA, AA- = High Grade Rating)*

Appendix 1 sets out the current list of countries that the Council can invest funds with.

The UK sovereign rating is currently AA. To ensure that the Treasury Function has capacity to operate effectively no specific minimum UK sovereign rating has been set out.

**Selection Criteria**

75 Banks 1 - the Council will use UK and non UK banks which have, as a minimum at least one of, the following Fitch, Moody's and Standard & Poors credit ratings (where rated):

| | **Fitch** | **Moody's** | **Standard & Poors** |
|---|---|---|---|
| Short Term | F1 | P1 | A-1 |
| Long Term | A- | A3 | A- |

76 Investments will include term deposits, call accounts, notice accounts and Certificate of Deposits.

a Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.

b Banks 3 – The Council's own banker (HSBC) for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

c Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

d Building societies. The Council will use societies which meet the ratings for Banks 1 outlined above.

e Money Market Funds

f Enhanced Money Market Funds

g UK Government (including gilts, Treasury Bills and the Debt Management Account Deposit Facility (DMADF))

h Local authorities, parish Councils, Bournemouth Borough Council Companies (Subsidiaries) and Partnerships etc

i Pooled Funds

**Maximum Time and Monetary Limits applying to Investments**

77 The maximum amount that can be invested in any one institution at the time of the investment (including call accounts) as a percentage of the total investment portfolio has been reviewed and rationalised. All AA- and above rated institutions have a maximum limit of 25%, all A+, A or A- rated institutions have a maximum limit of 20%. For practical reasons where the average investment balance falls below £10m it may become necessary to increase the percentage limit to 33% at the time of investment (this only applies to call accounts and money market funds).

78 The maximum time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

| | Long Term Rating | Money Limit | Time Limit |
|---|---|---|---|
| Banks 1 category | AA- | 25% | 2 years |
| Banks 1 category | A | 20% | 1 year |
| Banks 1 category | A- | 20% | 6 months |
| Banks 2 category – part-nationalised<br>Lloyds / Bank of Scotland<br>RBS / Nat West | N/A | 20% | <br>1 years<br>2 years |
| Banks 3 category – Council's banker HSBC | AA- | 25% | 3 months |
| DMADF/Treasury Bills | AAA | 25% | 6 months |
| Local Authorities | N/A | 20% | 5 years |
| Money Market Funds | AAA | 25% | Instant access |
| Enhanced Money Market Funds | AAA | 25% | Instant access |
| Pooled Funds | N/A | 25% | 5 years |
| UK Gilts | UK Sovereign Rate | 25% | 5 years |

## Investment strategy

### In-house funds

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

### Investment returns expectations

80 Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

a 2017/18 0.25%

b 2018/19 0.25%

c 2019/20 0.50%

81 The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

82 **Investment treasury limit** – The maximum period for investments will be 5 years.

**Appendix 1: Approved countries for investments**

- United Kingdom

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland