Harrogate
BOROUGH COUNCIL

Agenda Item No. 6

REPORT TO:	Audit and Governance Committee Cabinet
DATE:	9 January 2019 6 February 2019
SERVICE AREA:	Finance
REPORTING OFFICER:	Head of Finance *(Paul Foster)*
SUBJECT:	**TREASURY MANAGEMENT ANNUAL STRATEGY, ANNUAL INVESTMENT STRATEGY, PRUDENTIAL AND TREASURY INDICATORS, ANNUAL MINIMUM REVENUE PROVISION STATEMENT**
WARDS AFFECTED:	None
FORWARD PLAN REF:	N/A

1.0 PURPOSE OF REPORT

1.1 This report covers four topics related to Treasury Management. It is necessary to report on these in accordance with statutory requirements and codes of practice.

2.0 RECOMMENDATIONS

2.1 That the Treasury Management Annual Strategy is recommended to Council for approval (see Section 6).

2.2 That the Annual Investment Strategy is recommended to Council for approval (see Section 7).

2.3 That the Prudential and Treasury Indicators are recommended to Council for approval (see Section 8).

2.4 That the Annual Minimum Revenue Provision Statement is recommended to Council for approval (see Section 9).

3.0 RECOMMENDED REASON FOR DECISION

3.1 To comply with the authority's financial regulations and the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice.

4.0 ALTERNATIVE OPTION CONSIDERED AND RECOMMENDED FOR REJECTION

4.1 None.

5.0 INTRODUCTION

5.1 Background

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

5.1.2 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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

5.1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

5.1.4 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

5.1.5 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."

5.1.6 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury

Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy will be reported separately.

5.2 Reporting requirements

Capital Strategy

5.2.1 The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019/20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

5.2.2 The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

5.2.3 This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

Treasury Management

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

Treasury Management Strategy (this report)

The first, and most important report is forward looking and covers:

- the Treasury Management Strategy (how the investments and borrowings are to be organised).
- an investment strategy (the parameters on how investments are to be managed).
- prudential and treasury indicators.
- a MRP Policy (how residual capital expenditure is charged to revenue over time).

Mid-Year Treasury Management Report (November)

This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

Annual Treasury Management Report (July)

This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

5.2.5 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.

5.2.6 These reports cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

5.3 Training

5.3.1 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training was provided in January 2015 and it is expected that further training will be arranged soon.

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

5.4 Treasury Management Consultants

5.4.1 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

5.4.2 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. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

5.4.3 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.

6.0 TREASURY MANAGEMENT ANNUAL STRATEGY

6.1 Introduction

6.1.1 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 service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the current and projected debt positions, the annual investment strategy (section 7), the relevant prudential/treasury indicators (section 8) and the MRP statement (section 9).

6.2 Current Portfolio Position

6.2.1 The Council's treasury portfolio position at 31 March 2018, 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.

	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
External Debt					
Debt at 1 April	53.086	53.082	53.077	53.073	53.067
Expected change in Debt	-0.004	-0.005	-0.004	-0.006	-15.006
Actual Gross Debt at 31 March	53.082	53.077	53.073	53.067	38.061
CFR – the borrowing need	84.394	83.596	85.294	84.540	68.716
Under/(over) borrowing	31.312	30.519	32.221	31.473	30.655

6.2.2 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 2019/20 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 or speculative purposes.

6.2.3 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.

6.3 Prospects for Interest Rates

6.3.1 The Council has appointed Link 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 the central view.

Link Asset Services Interest Rate View	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

6.3.2 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the Monetary Policy Committee (MPC) came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor’s fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

6.3.3 The overall longer run future trend is for gilt yields, and consequently Public Works Loan Board (PWLB) rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the United States (US) Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Federal Reserve has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

6.3.4 Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

6.3.5 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, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

6.3.6 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 European Union (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.

Investment and borrowing rates

6.3.7
- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018/19 and have increased modestly since the summer. 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 (the difference between higher borrowing costs and lower investment returns) to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

6.4 Borrowing Strategy

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

6.4.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. We will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions would be reported to the appropriate decision making body at the next available opportunity.

6.5 Policy on Borrowing in Advance of Need

6.5.1 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 to ensure the security of such funds.

6.5.2 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.

6.6 Debt Rescheduling

6.6.1 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).

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

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

6.6.3 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.

6.6.4 The potential for rescheduling has been examined, but opportunities are not available given current interest rates are very low.

7.0 ANNUAL INVESTMENT STRATEGY

7.1 Investment Policy

7.1.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments (as managed by the treasury management team).

7.1.2 The Council's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities will be security first, portfolio liquidity second and then yield (return).

7.1.3 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** 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 achieve this consideration 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.

3. **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.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use.

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
   - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. The Council has determined that it will limit the maximum total exposure to investments, which still have more than 12 months to maturity, to £25 million or 50% of the authority's average overall investments, whichever is the lesser.

6. **Lending limits** (amounts and maturity) for each counterparty will be set through applying the policy in paragraph 7.2. The liquidity of investments shall be secured as follows:

    - The Head of Finance shall determine the maximum periods for which funds may prudently be committed. In practical terms, this means that decisions not exceeding 12 months are delegated to the Financial Services Manager and all other decisions being the subject of specific approval by the Head of Finance.
    - The minimum amount to be held in investments not exceeding 12 months shall be nil (0% of the authority's overall investments) provided that any consequent cash flow shortages are estimated to be cleared from income within one month.

7. **Transaction limits** are set for each type of investment in 7.2.

8. Investments will only be placed with counterparties from the UK. All investments shall therefore be with counterparties as follows:

    - the UK Government (including the UK Debt Management Office of HM Treasury) or a British local authority (except parishes) and including police/fire authorities
    - a British clearing or high street bank or building society with a credit rating (see section 7.2)

9. This authority has engaged **external consultants** (see paragraph 5.4) to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in **sterling**.

11. As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund (in November 2018, MHCLG concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1 April 2018).

7.1.4 However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance (see paragraph 7.4). Regular monitoring of investment performance will be carried out during the year.

7.2 Creditworthiness Policy

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

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

7.2.2 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 that indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised/semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour not to be used

7.2.3 The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system; it does not give undue preponderance to just one agency's ratings.

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

7.2.5 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

- in addition to the use of credit ratings the Council will be advised of information in movements in CDS spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the lending list.

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

UK banks – ring fencing

7.2.7 The largest UK banks (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits) are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1 January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

7.2.8 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank (RFB) will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

7.2.9 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings (and any other metrics considered) will be considered for investment purposes.

7.3 Investment Strategy

7.3.1 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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time

period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

7.3.2 **Investment returns expectations**. Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

7.3.4 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 1.75%

7.3.5 The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

7.4 Investment risk benchmarking

7.4.1 We will use an investment benchmark to assess the investment performance of our investment portfolio of 7 day LIBID rate.

7.5 End of year investment report

7.5.1 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Management Report.

8.0 PRUDENTIAL AND TREASURY INDICATORS

8.1 The CIPFA Prudential Code requires full Council to approve a range of indicators on treasury management issues. One of these is the Authorised Borrowing Limit, which the Local Government Act 2003 requires full Council to determine and review.

8.2 These various indicators are at the heart of the prudential borrowing system. Local authorities are free to borrow up to the level of their own prudential limits. These must be set in accordance with the Code, and with regard to the advice of the Head of Finance and to the various indicators of whether borrowing is affordable.

8.3 The limits can be reviewed during the course of the year, but since, under normal circumstances, they should not be broken they need to be set wide enough to cover all eventualities.

8.4 A summary of the practical implications of the Prudential Code appears at Appendix A, and the detailed prudential and treasury indicators themselves are portrayed at Appendix B (in the manner recommended by the Code).

9.0 ANNUAL MINIMUM REVENUE PROVISION STATEMENT

9.1 The Capital Finance Regulations require local authorities to charge to their revenue account for each financial year a minimum revenue provision (MRP) to account for the cost of their debt in that financial year.

9.2 Amendments to the above regulations replace the previous detailed calculation with a requirement to calculate MRP that local authorities consider to be prudent. The amendment does not define "prudent"; however, statutory guidance makes recommendations to authorities on the interpretation of that term.

9.3 The guidance recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full Council. The statement should indicate which options for calculating MRP have been followed. The Annual MRP Statement is set out at Appendix C.

10.0 REQUIRED ASSESSMENTS AND IMPLICATIONS

10.1 The following were considered: Financial Implications; Human Resources Implications; Legal Implications; ICT Implications; Strategic Property/Asset Management Considerations; Risk Assessment; Equality and Diversity (the Public Sector Equality Duty and impact upon people with protected characteristics). If applicable, the outcomes of any consultations, assessments, considerations and implications considered necessary during preparation of this report are included in the report.

11.0 RISK ASSESSMENT

11.1 The Treasury Management operation involves very large flows of payments, both in and out of the Council, processed electronically by the few staff involved. This activity inevitably brings with it a number of risks, with potentially high impact. These risks include the possibility of loss through counterparty default, staff fraud or error, exposure to varying interest rates, the use of complex instruments and techniques, and compliance with intricate regulatory requirements.

11.2 These risks are codified in the Section's Treasury Management Practices documentation, which sets out how these risks are to be managed. These methods include credit ratings of counterparties, a mature approach to market timing and techniques, and a very strong set of internal checks and controls.

11.3 It can be reported that these risk management arrangements remain of the highest order. They have been the subject of regular detailed inspection by Internal and External Audit, and have always received a full unqualified approval.

12.0 CONCLUSION

12.1 This report fulfils the statutory requirements, the requirements of the Treasury Management Code of Practice and the Council's financial procedure rules in respect of the four topics related to Treasury Management.

Background papers – None

OFFICER CONTACT: Please contact Paul Foster (Head of Finance) if you require any further information on the contents of this report. The Officer can be contacted at the Civic Centre, PO Box 787, Harrogate, HG1 9RW, by telephone on (01423) 556101 or by e-mail at paul.foster@harrogate.gov.uk.

APPENDIX A

THE CIPFA PRUDENTIAL BORROWING CODE

The Code In Outline

1. The Local Government Act 2003 allows Prudential Borrowing from 1 April 2004 having regard to the CIPFA Code.

2. The key elements are **Affordability and Strategic Focus**. When taking capital investment decisions, the Council is now required to have regard to:
   - **affordability** e.g. implications for Council Tax and Rents
   - **prudence and sustainability** e.g. implications for external borrowing
   - **value for money** e.g. options appraisal
   - **stewardship of assets** e.g. asset management planning
   - **service objectives** e.g. strategic planning for the authority
   - **practicality** e.g. achievability of the forward plan

   Capital programming should be integrated with the revenue budget (as at present).

3. During the budget process, the Council now has to set its two prudential limits on borrowing. These are an Authorised Limit (being a maximum to cover all eventualities) and an Operational Boundary (reflecting current debt outstanding plus any external borrowing for next year).

4. Council can revise the limits at any stage during the year, although in practice the original limits might include an allowance for new schemes emerging in-year (subject to their affordability and approval).

5. Ostensibly to inform the decision-making process, the Code requires the production of a specified range of Prudential Indicators of affordability e.g. debt outstanding, debt financing costs as a proportion of the revenue budget, the marginal effect on the council tax or on housing rents. At the end of the day though, these figures will not provide the answers. Councillors have to decide (with advice from the Head of Finance) how much they can afford to borrow, given the constraints on the revenue budget.

6. **In practice**, the constraints on the revenue budget mean that there is **not a great deal of freedom** actually available from the loosening of Government borrowing control. The General Fund has very little room for extra debt charges, unless these are offset by extra income (e.g. self-financing schemes) or alternatively are seen as unavoidable schemes that would otherwise have to be charged to revenue.

7. It is important to **manage expectations** under the new system. Prudential borrowing is not a free resource, it is like a domestic mortgage and requires revenue budget for the debt charges and any running costs. It is a long-term pre-emption of future revenue and council tax. Unless the revenue cost can be found within existing revenue budgets, then it should be treated as any other growth item.

Impact on Harrogate

8. **In practice** in Harrogate, the medium term financial prospects are constrained so that only **limited allowance for prudential borrowing** has been made, where supported by income or revenue savings. This includes the planned prudential borrowing for the new civic offices, which is supported by revenue savings.