Key Decision Required:	NO	In the Forward Plan:	NO

CABINET
22 JANUARY 2016

REPORT OF THE FINANCE AND TRANSFORMATION PORTFOLIO HOLDER

A.5 ANNUAL TREASURY STRATEGY FOR 2016/17 (INCLUDING PRUDENTIAL AND TREASURY INDICATORS)

(Report prepared by Richard Barrett and Wendy Borgartz*)*

PART 1 – KEY INFORMATION

PURPOSE OF THE REPORT

To seek Cabinet's agreement to the Annual Treasury Strategy for 2016/17 (including the Prudential and Treasury indicators) for consultation with the Corporate Management Committee.

EXECUTIVE SUMMARY

- The Annual Treasury Strategy for 2016/17 including as an annex to the strategy the Prudential and Treasury indicators is set out in **Appendix A**

- The Local Government Act 2003 and supporting regulations require the Council to set out its treasury strategy for borrowing, and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act) that sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments, "having regard" to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice.

- Under the Prudential Code the Council has freedom over capital expenditure as long as it is prudent, affordable and sustainable. The Prudential Indicators either measure the expected activity or introduce limits upon the activity, and reflect the underlying capital appraisal systems and enable the Council to demonstrate that it is complying with the requirements of the Prudential Code. The Annual Treasury Strategy for 2016/17 covers the various elements that satisfy the requirements of the various codes that govern the borrowing and investment activities of the Council.

- The Treasury Strategy has been prepared in the light of advice received from the Council's Treasury advisors and reflects the latest codes and guidance.

- The Council's investments will be undertaken in accordance with its Treasury Management Practices. These have been expanded to include use of non-specified investment in property to yield both rental income and capital gains from 2016/17. If credit ratings remain at their current low levels it is likely that a significant proportion of the Council's investments will continue to be in government securities such as Treasury Bills or with other Local Authorities. However other 'quality' investment opportunities will be explored in consultation with the Council's external advisors to maximise returns on investments within a continuing and overall risk-averse approach.

RECOMMENDATIONS
That Cabinet approves the Annual Treasury Strategy for 2016/17 (including Prudential and Treasury Indicators), for submission to the Corporate Management Committee for review before recommendation to Full Council.

PART 2 – IMPLICATIONS OF THE DECISION

DELIVERING PRIORITIES
The adoption of the Annual Treasury Strategy for 2016/17 will ensure that the Council's Treasury Management activities are carried out and managed in accordance with best practice, thereby safeguarding money held by the Council and making an appropriate contribution to the Council's overall financial position.

FINANCE, OTHER RESOURCES AND RISK
Finance and other resources Treasury Management Strategies and procedures will ensure that the Council's investments and borrowing will be undertaken in such a way as to minimise the Council's exposure to risk. At the same time they will maximise income from investments and minimise the costs of borrowing within the Council's accepted level of risk. **Risk** The placing of investments involves a number of risks. These risks and how the Council will manage them are set out in the Council's Treasury Management Practices.

LEGAL
The Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 include the requirement for local authorities to have regard to CIPFA guidance. By adopting / approving an Annual Treasury Strategy based on the requirements of the relevant and updated codes, the Council is complying with the regulations.

OTHER IMPLICATIONS
Consideration has been given to the implications of the proposed decision in respect of the following and any significant issues are set out below. **Crime and Disorder / Equality and Diversity / Health Inequalities / Area or Ward affected / Consultation/Public Engagement.** There are no other implications.

PART 3 – SUPPORTING INFORMATION

BACKGROUND AND CURRENT POSITION
The Annual Treasury Strategy for 2016/17 is set out in **Appendix A** and is based on CIPFA's latest Code of Practice. No significant changes are proposed with limited amendments in areas such as the general economic outlook and interest rate forecasts, with the Council maintaining a very low risk appetite approach to its treasury activities. In respect of CIPFA's Treasury Management Code of practice, the most recent and fundamental revision to the code was in 2009, which this Council formally adopted in March 2010. Revisions have been made to this code since 2010 which have been incorporated within subsequent Annual Treasury Strategies where relevant. By approving the Annual Treasury Strategy for 2016/17, the Council is in effect adopting the latest CIPFA Code of Practice for Treasury Management in the Public Services. (the '2011 code'). Although not specified within the Treasury Strategy, the need to borrow money may arise during 2016/17 in relation to the Garden Village Settlement project being explored in partnership with Colchester Borough Council. Although this project will be subject to separate decision making processes over the coming months, any borrowing requirements will need to be considered within the overall Treasury Strategy framework. Draft Prudential Indicators are set out in Annex 1 to the Treasury Strategy. These have been subject to a comprehensive review during the year in consultation with the Council's treasury advisors. The format has been changed along with the addition of brief introductions to each indicator with the aim of making them more understandable and useful to members and officers when undertaking borrowing / investment decisions. In accordance with the relevant codes, the Treasury Strategy is subject to consultation with the Corporate Management Committee before being recommended to Council for approval before the start of each financial year.

BACKGROUND PAPERS FOR THE DECISION
None

APPENDICES
Appendix A - Annual Treasury Strategy 2016/17

Tendring
District Council

PRO BONO OMNIUM
FOR THE GOOD OF ALL

ANNUAL TREASURY STRATEGY FOR 2016/17

January 2016

Annual Treasury Strategy for 2016/17

The Annual Treasury Strategy has been prepared in accordance with the CIPFA Code and includes the following sections.

1. Background

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

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Council's risk appetite is low and it has taken, historically, a risk-averse approach to Treasury Management, with the security and liquidity of the investment the prime concern, and the budget for income from investments being formulated on this basis. The Annual Strategy for 2016/17 is based on this risk-averse approach continuing.

For a number of years the Council has engaged the services of treasury advisors to provide its officers with advice on treasury management issues. The current advisors are Capita Asset Services, Treasury solutions (Formerly called Sector Treasury Services) (Sector). However the final decision and responsibility for the actions taken sits with the Council's own officers after considering that advice.

The details of the delegations and responsibilities for treasury management are contained within the Council's Constitution as follows:-

- Part 3 – delegated powers – The Executive / Finance and Transformation Portfolio Holder
- Part 5 – Financial Procedure Rules

2. Treasury Limits for 2016/17 to 2018/19

It is a statutory duty under Section 3 of the Act and supporting regulations for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The Council must have regard to the Prudential Code when setting the Authorised Limit of external debt, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in Annex 1 of this report.

The authorised limit reflects the additional borrowing requirement as part of the Housing Revenue Account (HRA) self-financing reforms. The Housing self-financing reforms also set an overall 'debt cap' for the HRA which in itself reflects an affordability level based on the Government's model of how much debt can be supported by the HRA after considering the forecast of income from rents and management and maintenance costs over a 30 year period. The HRA debt cap for Tendring is £60,285,000.

3. Prudential and Treasury Indicators for 2016/17 to 2018/19

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated Treasury Management Strategy. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The latest revision to the Code is effectively adopted via the approval of this Strategy which reflects the most up to date code and guidance.

4. Current Portfolio Position

The Council's treasury position at the end of November 2015 comprised:

- GF borrowing from The Public Works Loan Board (PWLB) of £1.189m at fixed rates at an average rate of interest of 8.23%
- HRA borrowing from the PWLB of £47.692m at fixed rates at an average rate of 3.26%
- Investments of cash flow surpluses, which include reserves and capital receipts, on a short-term basis (less than 1 year) totalling £48.586m at an average rate of interest of 0.39%.

5. Borrowing Requirement

No new, alternative or replacement borrowing is currently reflected in the budgets for the both the General Fund or HRA for the period 2015/16 to 2018/19. This position therefore excludes any assumptions on additional borrowing, which would be subject to further consideration as necessary set against the underlying principle of the Council's borrowing requirement being kept under on-going review to respond to any new / future burdens or priorities and overall financial position.

6. Economic Position

The Council's Treasury Advisors provide useful economoic updates during the year with the latest position set out as follows:

Since the summer worldwide economic statistics have distinctly weakened, which has raised concerns for the potential impact on the UK. In the

Eurozone, the ECB began a programme of quantitative easing in March 2015. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 but came in at 0.4% in quarter 2 and 0.3% in quarter 3. The financial challenges faced by Greece still remain which introduces a significant level of risk into the european economy.

The US economy made a strong comeback after a weak first quarter's growth at 0.6% to 3.9% in quarter 2 of 2015, but then weakened again to 2.1% in quarter 3. The downbeat news in late August and September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, strong figures for employment in October contributed to the US rate rise in December.

UK economy

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country and the 2015 growth rate is likely to be a leading rate in the G7 again. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5-2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Inflation is expected to increase to around 1% in the second half of 2016, but there is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing the Bank Rate.

Investment returns are likely to remain relatively low during 2016/17 and beyond. Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenomenally low levels during 2015. The policy of avoiding new borrowing by using cash balances has served well over the last few years. However, this needs to be carefully balanced to avoid incurring higher borrowing costs in later times, when authorities may not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt.

7. Interest Rates

The following table gives the Council's External Treasury Advisor's view on Bank Rate movements and their forecast for the PWLB new borrowing rate based on that view. The PWLB rates are based on the 'Certainty Rate' introduced by the Government for local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. Investment returns are likely to remain relatively low during 2016/17 and beyond.

	Bank Rate	LIBID (London Interbank Bid Rate)*			PWLB Borrowing Rate			
		3 month	6 month	12 month	5 yr.	10 yr.	25 yr.	50 yr.
Mar 2016	0.50	0.70	0.90	1.20	2.40	3.00	3.70	3.60
Jun 2016	0.75	0.80	1.00	1.30	2.60	3.10	3.80	3.70
Sep 2016	0.75	0.90	1.10	1.40	2.70	3.20	3.90	3.80
Dec 2016	1.00	1.10	1.30	1.60	2.80	3.30	4.00	3.90
Mar 2017	1.00	1.30	1.50	1.80	2.80	3.40	4.10	4.00
Jun 2017	1.25	1.40	1.60	1.90	2.90	3.50	4.10	4.00
Sep 2017	1.50	1.50	1.70	2.00	3.00	3.60	4.20	4.10
Dec 2017	1.50	1.80	2.00	2.30	3.20	3.70	4.30	4.20
Mar 2018	1.75	1.90	2.10	2.40	3.30	3.80	4.30	4.20
Jun 2018	1.75	1.90	2.10	2.40	3.40	3.90	4.40	4.30
Sep 2018	2.00	2.00	2.20	2.50	3.50	4.00	4.40	4.30
Dec 2018	2.00	2.00	2.20	2.50	3.50	4.10	4.40	4.30
Mar 2019	2.00	2.10	2.30	2.70	3.60	4.10	4.50	4.40

** LIBID – the rate at which a bank is willing to borrow from other banks*

8. Borrowing Strategy

8.1 External v Internal Borrowing

The main Prudential Indicator relevant to capital investment is the Capital Financing Requirement (CFR). This is the total outstanding capital expenditure that has not yet been funded from either revenue or capital resources and is therefore a measure of the Council's underlying borrowing need after taking into account the provision included in the revenue budgets for the repayment of outstanding debt.

The borrowing to finance the capital expenditure can be either from external sources or the Council can use its own internal resources.

The planned external debt compared to the CFR over 5 years is shown in the following table, the difference between the two being the amount the Council has funded from internal resources. This is also set out separately for the GF and the HRA. This excludes other long term liabilities such as long term creditors and pensions which form part of the separate Financial Strategy process of the Council from a prudential perspective.

Total External Debt

	Actual 2014/15	Revised 2015/16	Estimate 2016/17	Forecast 2017/18	Forecast 2018/19
	£000's	£000's	£000's	£000's	£000's
Debt as at 1 April	52,550	50,344	48,117	45,869	43,898
Estimated change in debt	(2,206)	(2,227)	(2,248)	(1,971)	(1,822)
Estimated debt as at 31 March	50,344	48,117	45,869	43,898	42,076
CFR as at 31 March	**55,709**	**53,477**	**51,256**	**49,346**	**47,446**
Difference - internally financed	5,365	5,360	5,387	5,448	5,370

General Fund External Debt

	Actual 2014/15	Revised 2015/16	Estimate 2016/17	Forecast 2017/18	Forecast 2018/19
	£000's	£000's	£000's	£000's	£000's
Debt as at 1 April	1,559	1,317	1,055	771	464
Estimated repayment of debt	(242)	(262)	(284)	(307)	(158)
Estimated debt as at 31 March	1,317	1,055	771	464	306
CFR as at 31 March	**6,682**	**6,415**	**6,158**	**5,912**	**5,676**
Forecast of internal financing	5,365	5,360	5,387	5,448	5,370

HRA External Debt

	Revised 2014/15	Estimate 2015/16	Forecast 2016/17	Forecast 2017/18	Forecast 2018/19
	£000's	£000's	£000's	£000's	£000's
Debt as at 1 April	50,991	49,027	47,062	45,098	43,434
Estimated repayment of debt	(1,964)	(1,965)	(1,964)	(1,664)	(1,664)
Estimated debt as at 31 March	49,027	47,062	45,098	43,434	41,770

CFR as at 31 March	**49,027**	**47,062**	**45,098**	**43,434**	**41,770**
Forecast of internal financing	0	0	0	0	0

In respect of the General Fund, 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 external loans as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains prudent, as investment returns are low and counterparty risk is high, and will be continued.

The Council's officers have made an assessment, based on advice from treasury advisors, of the amount of internal resources that it is prudent to use to finance capital expenditure and it is felt, taking into account the Council's financial position, that approximately £4m-£5m would at the present time and over the medium term be an appropriate level of internal borrowing. A maturity loan of £1m fell due for repayment in 2014 but this was not replaced which has led to the current internal borrowing position running just ahead of the £5m level. However given the continuing low return on investments and no significant increases in PWLB interest rates in the immediate future, it is felt prudent to maintain this position in the short term although this will be kept under review in consultation with the Council's external advisors.

The use of internal resources is only a temporary solution as, in time, these reserves and capital receipts will be utilised to finance service initiatives and capital investment and at that point will not be available. This will need to be balanced against the replacement external borrowing which will be required at some point in the future which may attract higher rates of interest, so timing of such borrowing will need to consider forecasted rates of interest against the various types of borrowing structure to determine the most advantageous approach. Against this approach consideration may be required to borrow in advance of need, as set out in section 8.3 below, so as to reduce the need to borrow when interest rates may be higher.

8.2 Gross Debt v Investments

A comparison between the Council's gross and net borrowing position helps to assess the credit risk that would apply if the Council has surplus resources invested at a low interest rate which could be used to repay existing debt or to negate the need for additional new debt if at higher interest rates than that being achieved on the investments.

The table below sets out the Council's probable position taking account of both the individual GF and HRA debt figures.

Comparison of gross and net debt positions at year end	2014/15	2015/16	2016/17	2017/18	2018/19
	actual	Probable out-turn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
General Fund external debt (gross)	1,317	1,055	771	464	306
HRA external debt (gross)	49,027	47,062	45,098	43,434	41,770
Investments	37,752	37,200	15,000	15,000	15,000
Net debt	**12,592**	**10,917**	**30,869**	**28,898**	**27,076**

The net debt positions show that the Council does not have excess resources which could be used to repay long term debt.

If opportunity arises, external debt will be repaid early, although this is difficult under current arrangements as set out in section 9. If borrowing is required then any requirement will be considered whilst balancing internal resources and forecasted interest rates within the parameters previously set out.

Against this background caution will be adopted within the 2016/17 treasury operations. Interest rates will be monitored and a pragmatic approach adopted to changing circumstances with appropriate action taken in accordance with the Council's Financial Procedure Rules.

8.3 Policy on borrowing in advance of need

The Council cannot 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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile 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 on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

9. Debt Rescheduling

Officers together with the treasury advisors examine on a regular basis the potential for undertaking early repayment of some external debt to the PWLB in order to maximise any potential financial advantages to the Council. However, the continuing and significant difference between new borrowing and repayment rates has meant that large premiums would be incurred by such action and cannot be justified on value for money grounds. This situation will be monitored in case the differential is narrowed by the PWLB or repayment rates change substantially.

As short term borrowing rates will be cheaper than longer term rates there may be some potential for some residual 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 size of premiums incurred, their short term nature, and the likely cost of refinancing these short term loans once they mature compared to the current rates of longer term debt in the existing portfolio.

Any opportunities for debt rescheduling will be considered if such action would be advantageous to the Council. 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 strategy outlined above
- enhance the balance of the portfolio

Consideration will also be given to identifying if there is any residual potential left 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.

10. Annual Investment Strategy

10.1 Investment Policy

The Council will have regard to the Department of Communities and Local Government's (CLG) Guidance on Local Government Investments, the latest CIPFA Treasury Management in Public Services Code of Practice and Guidance Notes (the Code) along with any relevant revisions or updates. The Council's investment priorities when investing are: -

- The security of capital and
- The liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with these main priorities. It is important to note that the borrowing of monies purely to invest or on-lend and make a return is unlawful.

Investment instruments identified for use in the financial year are listed in Annex 2 under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.

The majority of the Council’s investments will be in Specified Investments although limited investments may be made in Non- Specified investments.

The capital programme for 2016/17 includes £750,000 to establish a commercial property investment fund, which is a Non-Specified investment. This fund will be used to purchase property with the aim of yielding both rental income and capital gains. This investment will not have a defined maturity date and it will be an illiquid investment as the Council would need to sell the underlying asset(s) to redeem the investment. The amount invested in any one year will be limited to the amount included within the Council’s Capital Programme, with information submitted to members separately to address / acknowledge the priorities and risks set out elsewhere in this strategy as part of the budget setting framework, including future funding decisions. At present it is proposed to fund the scheme from existing capital receipts, so there is no current need to borrowing for this investment.

A separate policy will be presented to members before any investment in property is undertaken, which will set out the necessary financial and governance arrangements around such investment. This policy will be maintained as a separate document within the wider Treasury Strategy framework.

The Council does not intend to use derivative instruments as part of its treasury activities during the year.

10.2 Creditworthiness Policy and changes to the credit rating methodology

This Council uses credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. In determining the appropriate credit rating the Council will use the lowest rating available to determine the investment limits both in terms of amount and period for a particular counterparty. This is in accordance with the recommendations of The Code. Counterparties rated by only one agency will not be used.

One of the credit rating agencies may be more aggressive in giving lower ratings than the other two agencies and this could result in the Council's counterparty list becoming too restrictive. If this happens the position will be discussed with the Council's treasury advisors and the Treasury Management Practices may need to be revised in accordance with delegated powers set out in the Council's Constitution.

- All credit ratings will be monitored daily**.** The Council is alerted to changes to ratings of all three agencies through its use of the Creditworthiness Service provided by the Council's external advisors which is received each morning via email and uploaded to the Treasury Management system.
- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use for a new investment will be withdrawn immediately.

The Code also recommends that credit ratings are not the sole determinant of creditworthiness and therefore the Council will also use available market information from a variety of sources including

1. The Creditworthiness Service utilises movements in Credit Default Swaps against the iTraxx benchmark and other market data on a weekly basis. This creditworthiness service information will be used to confirm the assessed creditworthiness derived from the three ratings agencies. Where the information from this service indicates a lower standing for a particular counterparty than that derived via the credit ratings then the investment limits and length of investments applicable to that counterparty will be adjusted accordingly or the counterparty removed from the list.
2. Market data and information,
3. Information on government support for banks and the credit ratings of that government support

10.3 Credit Limits

Through its approved Treasury Management Practices the Council will set maximum limits for the amount that can be invested with any counterparty. This limit will be determined by reference to the counterparty's credit rating and other criteria. In addition the amount invested in building societies and Certificates of Deposit is also limited to 50% of the total investment portfolio.

100% of the Council's investments may be in Treasury Bills or Gilts or invested with the Government's Debt Management Office (DMO). Although these sums are very secure the rate of interest is usually lower than the market rate, however Treasury Bills are a valuable tool in providing security and liquidity whilst the DMO offers a variety of investment terms and is a valuable source of investment should credit ratings of other financial institutions result in a reduction in the number of counterparties that meet the Council's minimum credit rating criteria. There is no limit on the amount that can be invested with other local authorities in total, although there is a limit of £4 million with each individual local authority.

10.4 Country Limits

The Council has determined that it will only use approved counterparties from the UK and those countries with a minimum sovereign credit rating of AA or equivalent from the relevant rating agencies.

In a similar way that individual counterparties have a maximum investment limit, countries other than the UK will also have a limit.

10.5 Investment Strategy

The Council's funds are managed in-house and are mainly cash flow based but there is a core balance that could be available for investment for longer periods (2-3 years). 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) and in respect of property investment, this will be limited to the amount included in the Capital Programme.

The bank rate is now forecast to commence rising around the middle of 2016 but then to rise steadily from thereon (see Section 7). The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile without compromising the Council's priority of security of the investments.

For 2016/17 the Council has budgeted for investment returns based on the principles set out in this strategy including the forecast position on interest rates.

For its cash flow generated balances the Council will seek to utilise its business reserve accounts and short dated deposits (overnight to three months) in order to benefit from the compounding of interest. At the present time these short dated deposits are paying interest rates at or above base rate and provide a good level of liquidity to help manage the Council's cash flow.

10.6 Allocation of Investment returns between GF and HRA

As part of the introduction of HRA Self Financing a policy on the allocation of investments returns across the GF and HRA now forms part of the Annual Treasury Strategy.

The HRA holds balances and would benefit from cash flow advantages, which are amalgamated for the purposes of the overall investment activity of the

Council. At the end of each year the transfer to the HRA of its share of the authority's overall investment returns will be agreed by the S151 Officer in consultation with the relevant officers based on the following principles:

- Equity
- Risk Sharing
- Minimising volatility between years

Any returns from investing in property will be allocated to the relevant fund where Capital Programme / investment were made from.

10.7 End of year investment report

At the end of the financial year the Cabinet will receive a report on its investment activity.

GLOSSARY OF TERMS

Affordable borrowing limit – limit that the Council has to set under the CIPFA Prudential Code that shows how much the Council considers it can afford to borrow taking all its outgoings into consideration and how much income it considers it can generate.

Alternative financing arrangements – how the Council intends to finance its capital expenditure by other means besides borrowing.

Authorised limit – the amount the Council determines is the maximum that can be borrowed that is affordable and has been calculated in accordance with the legislation behind the CIPFA Prudential Code.

Borrowing requirement – how much the Council considers it needs to borrow to fund its spending plans.

CFR – Capital Financing Requirement – this calculation shows how much the Council needs to borrow or finance by some other measure to meet its planned capital spend.

Counterparty – the other party that participates when a loan or investment is placed.

CPI – Consumer Price Index – the Government's preferred measure of inflation, based on a set basket of goods and services. It excludes housing costs such as mortgage interest payments and council tax.

Credit arrangement – any quasi-loan, to ensure the legislation and Code pick up any unusual arrangements to provide funding other than from a straightforward loan

Credit default swap - A swap designed to transfer the credit exposure of fixed income products between parties. A credit default swap is also referred to as a credit derivative contract, where the purchaser of the swap makes payments up until the maturity date of a contract. Payments are made to the seller of the swap. In return, the seller agrees to pay off a third party debt if this party defaults on the loan. A CDS is considered insurance against non-payment. A buyer of a CDS might be speculating on the possibility that the third party will indeed default.

Credit limit – the maximum amount that can be lent to an individual organisation or group of organisations.

Credit rating – provided by one of the three credit rating agencies, an assessment of how likely the organisation is to repay any monies lent to it.

Creditworthiness - An assessment of the likelihood that a borrower will default on their debt obligations. It is based upon factors, such as their history of repayment and their credit score. Lending institutions also consider the availability of assets and extent of liabilities to determine the probability of default.

Debt cap (HRA) – the limit on the amount that can be borrowed by the HRA, set by central government.

Earmarked reserves – reserves that have been set aside for a specified purpose.

GDP – Gross Domestic Product – measures the output from the economy, if it rises then the economy is growing, if it falls the economy is in recession.

iTraxx - A group of international credit derivative indexes that are monitored by the International Index Company (IIC). The credit derivatives market that iTraxx provides allows parties to transfer the risk and return of underlying assets from one party to another without actually transferring the assets. iTraxx indexes cover credit derivatives markets in Europe, Asia and Australia.

Non-specified investment – as defined in Annex 2.

Prudential indicators – a series of calculated figures specified in the CIPFA Prudential Code which are used to assess how affordable and realistic the Council's spending and financing plans are.

PWLB – Public Works Loans Board – central government lending to other public sector bodies, specifically local government.

PWLB Certainty Rate – The PWLB sets various rates for borrowing. From 1 November 2012 the Government reduced the interest rates on loans from PWLB to Councils who provide information as required on their planned long-term borrowing and capital spending by 0.20%. This reduced rate is called the Certainty Rate.

Replacement borrowing – borrowing taken out to replace other borrowing or other forms of credit that have been repaid.

RPI – Retail Price Index – another inflation index, this one includes the cost of housing.

Specified investments – as defined in Annex 2.

Proposed Prudential Indicators 2015/16 revised, 2016/17 and forecasts for 2017/18 to 2018/19

CAPITAL EXPENDITURE

This is an estimate of the amount of investment planned over the period. As can be seen, not all investment necessarily has an impact on the Council Tax, schemes funded by grants, capital receipts or external contributions mean that the effect on the Council Tax is greatly reduced.

Capital Expenditure - General Fund £000s	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
Total Capital Expenditure	**16,850**	**31,307**	**1,940**	**890**	**890**
Financing - General Fund					
External contributions	-1,152	-5,151	-	-	-
Section 106	-149	-139	-	-	-
Leasing/contract hire	-	-283	-	-	-
Coast protection grant	-11,684	-15,906	-	-	-
Other Government grants	-42	-358	-	-	-
Disabled Facilities Grant	-1,007	-1,645	-690	-690	-690
Capital receipts	-370	-1,103	-850	-100	-100
Direct revenue contributions	-1,071	-532	-400	-100	-100
Earmarked reserves	-1,375	-6,190	-	-	-
Total Capital Financing	**-16,850**	**-31,307**	**-1,940**	**-890**	**-890**
Net Financing need (External Borrowing)	**0**	**0**	**0**	**0**	**0**

Housing Revenue Account Capital Schemes £000	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
Total Capital Expenditure	**5,470**	**6,276**	**4,030**	**4,244**	**4,238**
Financing - Housing Revenue Account					
Major repairs reserve	-3,726	-3,682	-3,250	-3,244	-3,238
Direct revenue contributions	-438	-2,394	-780	-1,000	-1,000
Section 106	-102	-	-	-	-
External Contributions	-152	-	-	-	-
Capital grant	-1,052	-200	-	-	-
Total Capital Financing	**-5,470**	**-6,276**	**-4,030**	**-4,244**	**-4,238**
Net Financing need (External Borrowing)	**0**	**0**	**0**	**0**	**0**

CAPITAL FINANCING REQUIREMENT

Each year, the Council finances the capital programme by a number of means, one of which could be borrowing. The Capital Financing Requirement (CFR) represents the cumulative amount of borrowing that has been incurred to pay for the Council's capital assets, less amounts that have been set aside for the repayment of debt over the years. The Council is only allowed to borrow long term to support its capital programme. It is not allowed to borrow long term to support its revenue budget.

CAPITAL FINANCING REQUIREMENT	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£000	£000	£000	£000	£000
General Fund	6,682	6,415	6,158	5,912	5,676
Housing Revenue Account	49,027	47,062	45,098	43,434	41,770
Total	**55,709**	**53,477**	**51,256**	**49,346**	**47,446**

HRA LIMIT ON INDEBTEDNESS

The Council is required to report the level of the limit imposed (or subsequently amended) at the time of the implementation of self-financing by the Department for Communities and Local Government. This is to be compared to the Housing Revenue Account capital financing requirement.

PRUDENTIAL INDICATOR	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£000	£000	£000	£000	£000
Limit on indebtedness	60,285	60,285	60,285	60,285	60,285
Capital Financing Requirement	49,027	47,062	45,098	43,434	41,770
Headroom	11,258	13,223	15,187	16,851	18,515

GROSS DEBT AND THE CAPITAL FINANCING REQUIREMENT

This indicator compares the Capital Financing Requirement to the level of external debt and shows how much of the capital programme is financed from internal resources. The capital programme is partially funded in the short to medium term by internal resources when investment interest rates are significantly lower than long term borrowing rates. Net interest payments are, therefore, optimised.

PRUDENTIAL INDICATOR	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£000	£000	£000	£000	£000
Capital Financing Requirement	55,709	53,477	51,256	49,346	47,446
External debt	50,344	48,117	45,869	43,898	42,076
Internal borrowing	5,365	5,360	5,387	5,448	5,370

OPERATIONAL BOUNDARY AND AUTHORISED LIMIT

The Council must set an operational boundary and authorised limit for external debt. The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It reflects the decision on the amount of debt needed for the Capital Programme for the relevant year. It also takes account of other long term liabilities, which comprise finance leases, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt. The Council has none of these at present.

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

PRUDENTIAL INDICATOR	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£000	£000	£000	£000	£000
Operational boundary - borrowing	73,832	76,627	67,491	67,129	66,974
Authorised limit - borrowing	82,036	85,141	74,990	74,588	74,415

RATIO OF FINANCING COSTS TO NET REVENUE STREAM

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

ESTIMATE OF THE RATIO OF FINANCING COSTS TO NET REVENUE	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	%	%	%	%	%
General Fund	1.13	0.89	0.76	0.48	0.24
Housing Revenue Account	56.92	65.74	51.90	51.49	51.66

INCREMENTAL IMPACT OF CAPITAL INVESTMENT DECISIONS

This is an indicator of affordability that shows the impact of capital investment decisions on the Council Tax and housing rent levels. The incremental impact is the difference between the revenue funding of the proposed capital programme compared to the revenue funding of the previously approved capital programme. As the Council is not proposing any additional borrrowing, this means that the impact is solely due to changes in revenue financing of capital expenditure. The increase in Council Tax impact in 2015/16 is mainly due to the Clacton and Holland coast protection scheme. The increase in HRA weekly rents is due to the decision to finance up to £1m of spend from revenue resources each year.

INCREMENTAL IMPACT OF CAPITAL INVESTMENT	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£	£	£	£	£
Change in General Fund capital spend financed by loan	-	-	-	-	-
Change in General Fund capital spend financed from revenue	-	3,484,000	250,000	-	-
General Fund, Council Tax impact	-	£77.58	£5.57	£0.00	£0.00
Change in HRA capital spend financed by loan	-	-	-	-	-
Change in HRA capital spend financed from revenue and major repairs reserve	-	1651000	(220,000.00)	-	-
HRA Average Weekly Rent impact	-	£10.05	(£1.34)	£0.00	£0.00

INTEREST RATE EXPOSURE

Tendring District Council currently has all its borrowings at fixed rate and usually has a mixture of fixed and variable rate investments. This indicator is set to control the Council's exposure to interest rate risk.

PRUDENTIAL INDICATOR	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£000	£000	£000	£000	£000
Upper limit for Fixed Interest Rates on debt	55,709	53,477	51,256	49,346	47,446
Upper limit for Variable Interest Rates on debt (based on 30% of the fixed rate limit)	16713	16043	15377	14804	14234

TOTAL PRINCIPAL SUMS INVESTED FOR PERIODS LONGER THAN 364 DAYS (excluding property)

Interest rate risk is also affected by the proportion of the investments invested at fixed rates for longer periods, especially in a period when rates are expected to rise.

PRUDENTIAL INDICATOR	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Forecast	2018/19 Forecast
	£000	£000	£000	£000	£000
Limits on the total principal sum invested to final maturities longer than 364 days	3,500	3,500	3,500	3,500	3,500

MATURITY STRUCTURE OF FIXED RATE BORROWING

This indicator is set to control the Council's exposure to refinancing risk. The limits are set for each age range to ensure that the Council avoids too many fixed rate loans being matured at one time and spreads the maturity across several periods. The percentages for the upper and lower limits do not add up to 100% as they do not represent an actual allocation.

PRUDENTIAL INDICATOR	Upper limit	Lower limit	Estimated outstanding debt maturity % at			
	%	%	31/03/2016	31/03/2017	31/03/2018	31/03/2019
Under 12 months	25	0	4.67%	4.30%	4.15%	4.19%
12 months and within 24 months	30	0	4.10%	7.82%	7.94%	8.06%
24 months and within 5 years	60	0	11.03%	21.06%	12.11%	14.90%
5 years and within 10 years	75	0	21.53%	17.69%	21.97%	19.28%
10 years and above	95	25				
10-20 years			22.23%	14.84%	17.16%	16.18%
20-30 years			5.27%	1.60%	2.50%	1.74%
>30 years			31.17%	32.70%	34.17%	35.65%

TREASURY INDICATOR - EXPOSURE TO CREDIT RISK

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) using the rating applicable when it is taken out and taking the arithmetic average, weighted by the size of each investment. Investments in government instruments such as DMO, treasury bills and in local authorities are scored as 1.

TREASURY INDICATOR	2014/15 Actual	2015/16 to 31 Dec	2016/17 Upper limit
Average credit score for investments	1.33	1.43	2.00

SPECIFIED AND NON-SPECIFIED INVESTMENTS

This schedule sets out the specified and Non-Specified investments the Council may use in 2016/17.

Investments may be in the form of direct deposits, Certificates of Deposits (CDs), property or the purchase of financial instruments such as Treasury Bills, Bonds and Gilts.

SPECIFIED INVESTMENTS:
An investment is a Specified Investment if all of the following apply

1. The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling
2. The investment is not a long term investment which is one that is due to be repaid within 12 months of the date on which the investment is made or one which the local authority may require to be repaid within that period.
3. The investment is not defined as capital expenditure by regulations
4. The investment is made with a body or in an investment scheme of high credit quality or the investment is made with the following public sector bodies.
    a. UK Government
    b. Local authority
    c. Parish council or community council

Where an investment is being made with a UK nationalised or part nationalised bank this will be treated for the purposes of classification as a Specified or Non-specified investment as being invested with the UK Government.

High credit quality
For a counterparty to meet the high credit quality criteria for specified investments, that counterparty must meet as a minimum the ratings of the three credit rating agencies listed below, and not be the subject of any adverse indications from the following sources.

- o Credit Default Swap index
- o The quality financial press
- o Market data
- o Information on government support for banks and
- o The credit ratings of that government support

Ratings	**Fitch**	**Moodys**	**Standard & Poors**
Short term	F1	P-1	A-1
Long term	A-	A3	A

NON SPECIFIED INVESTMENTS

A maximum of £3.5m may be held, in aggregate, in Non-Specified Investments

The only Non-Specified investments that the Council will use in 2016/17 are investments for periods of longer than 12 months with any institution or investment instrument that would have been classed as a Specified Investment if the investment had been for less than 12 months or property.