REPORT FOR:	GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE
Date of Meeting:	31 January 2017
Subject:	Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2017/18
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix A – Legislation and Regulations Impacting on Treasury Management Appendix B – Treasury Management Delegations and Responsibilities Appendix C – Minimum Revenue Provision (MRP) Policy Statement Appendix D – Interest Rate Forecasts 2016-20 Appendix E - Economic Background Appendix F - Counterparties Appendix G - Affordability Prudential Indicators

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Harrow COUNCIL
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Summary
This report sets out the Council's Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2017/18.

Recommendation
The Committee is asked to review and comment on the Treasury Management Strategy Statement for 2017/18 including:

- Prudential Indicators for 2017/18;
- Minimum Revenue Provision Policy Statement for 2017/18;
- Annual Investment Strategy for 2017/18; and
- Increase in investments held over 364 days (Paragraph 82)

Reason
To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

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Section 2 – Report

1. INTRODUCTION

1.1 Background

1. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

   The Council has adopted this definition.

2. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first main function 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 with approved counterparties or instruments commensurate with the Council's current investment strategy, providing adequate liquidity initially before considering investment return.

3. The second main function of the Treasury Management service is the funding of the Council's capital programme. This programme provides 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.

4. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code (The Prudential Code for Capital Finance in Local Authorities [CIPFA 2011 Edition]) and Treasury Management Code (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes [CIPFA 2011 Edition]), in setting Treasury and Prudential Indicators for the next three years and in ensuring that the Council's capital investment programme is affordable, prudent and sustainable.

5. The Act, the Codes and Department for Communities and Local Government Investment Guidance (2010) require the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. A summary of the relevant legislation, regulations and guidance is included as Appendix A.

6. The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Treasury Management Code, increases in capital expenditure should be limited to levels whereby increases in interest charges and running costs are affordable within the projected income of the Council for the foreseeable future.

7. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

8. The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.2 CIPFA requirements

9. The Council has formally adopted the Treasury Management Code, the primary requirements of which are as follows:

    - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

    - Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

    - Receipt by the full Council and/or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

    - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

    - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

1.3 Reporting requirements

10. As introduced above, the Council and/or Cabinet are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Treasury Management Strategy Statement report (this report) - The first, and most important report is presented to the Council in February and covers:

- the capital programme (including Prudential Indicators);
- an MRP Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

Mid-year Review report – This is presented to Cabinet in the autumn and updates Members on the progress of the capital position, reporting on Prudential Indicators and recommending amendments when necessary and identifying whether the treasury strategy is meeting the objectives or whether any policies require revision.

Treasury Management Outturn report – This is presented to Cabinet in June/July and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Strategy.

Scrutiny - The above reports are required to be adequately scrutinised, normally before being recommended to Cabinet / Council, with the role being undertaken by the Governance, Audit, Risk Management and Standards Committee (GARMSC).

11. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Section 151 officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions.

12. Further details of responsibilities are given in Appendix B.

1.4 Training

13. The Treasury Management Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in this area. This especially applies to Members responsible for scrutiny.

14. The Council's Treasury Management Adviser has recently presented an updated training session for all Members of GARMSC and other interested Members and other training opportunities will be offered as appropriate.

15. The training needs of Treasury Management officers are periodically reviewed as part of the Learning and Development programme with appropriate training and support provided.

1.5 Treasury Management Adviser

16. The Council has engaged Capita Asset Services, Treasury Solutions as its external Treasury Management Adviser.

17. However, the Council recognises that responsibility for treasury management decisions remains with itself at all times and will ensure that undue reliance is not placed upon external service providers.

18. 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 is assessed are properly agreed and documented, and subjected to regular review.

1.6 Treasury Management Strategy for 2017/18

19. The Strategy covers:-

Capital Issues (Section 2)

- Capital programme and capital prudential indicators 2017-18 to 2019-20 (Sub-section 2.1);
- Capital Financing Requirement (Sub-section 2.2);
- Minimum Revenue Provision Policy Statement (Sub-section 2.3 and Appendix C); and
- Core funds and expected investment balances (Sub-section 2.4).

Treasury Management Issues

- <u>Borrowing (Section 3)</u>
  - Current and estimated portfolio position (Sub-section 3.1);
  - Treasury indicators: limits to borrowing activity (Sub-section 3.2);
  - Prospects for interest rates and economic commentary (Sub-section 3.3 and Appendices D and E);
  - Borrowing strategy (Sub-section 3.4);
  - Treasury management limits on activity (Sub-section 3.5);
  - Policy on borrowing in advance of need (Sub-section 3.6); and
  - Debt rescheduling (Sub-section 3.7).

- <u>Annual Investment Strategy (Section 4)</u>
  - Investment policy (Sub-section 4.1);
  - Creditworthiness policy (Sub-section 4.2);
  - Country limits (Sub-section 4.3);
  - Annual Investment Strategy (Sub-section 4.4);
  - Investment risk benchmarking (Sub-section 4.5); and
  - End of year investment report (Sub-section 4.6).

Affordability Prudential Indicators (Section 5 and Appendix G)

20. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Department for Communities and Local Government (DCLG) Minimum Revenue Provision Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

21. It is not considered necessary to produce a separate treasury strategy for the Housing Revenue Account (HRA) in light of the co-mingling of debt and investments between HRA and the General Fund. Where appropriate, details of allocations of balances and interest to HRA are contained in this report.

2. CAPITAL ISSUES

22. The Council's capital expenditure programme is the key driver of treasury management activity. The output of the programme is reflected in the Prudential Indicators, which are required by the Prudential Code and are designed to assist Members' overview. The values shown in the tables for 2015-16 and 2016-17 are actual and estimated outturn respectively and not the strategy for those years.

2.1 Capital Programme and Capital Prudential Indicators 2017-18 to 2019-20

23. This prudential indicator is a summary of the Council's capital expenditure based on the approved capital programme. Amendments may be necessary in the light of decisions taken during the budget cycle. The table below summarises the capital programme and the ways in which it will be financed. Any shortfall of resources results in a financing need.

Table 1 Capital Expenditure and Funding

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Expenditure							
Community	22,043	43,122	52,831	47,154	19,883		
People Services	47,419	20,372	17,315	8,670	7,000		
Regeneration & Planning	2,402	11,899	46,130	197,870	81,638	3,827	756
Resources & Commercial	7,884	19,448	9,949	4,893	6,700		
HRA	13,553	14,016	15,238	8,639	8,639		
TOTAL	**93,301**	**108,857**	**141,463**	**267,226**	**123,860**	**3,827**	**756**
Funding:-							
Capital grants	51,827	29,997	15,108	16,746	5,805		
Capital receipts	3,282	11,843	2,563	1,248	93,024	3,746	12,752
Revenue financing	9,233	2,173	10,278	7,321	7,292		
Section 106 / Section 20	270	447	221	70	70		
TOTAL	**64,612**	**44,460**	**28,170**	**25,385**	**106,191**	**3,746**	**12,752**
Net financing need for the year	**28,689**	**64,397**	**113,293**	**241,841**	**17,669**	**81**	**- 11,996**

The capital programme overall is being agreed to 2019/20 whilst the Regeneration programme has been agreed for a further two years.

2.2 Capital Financing Requirement

24. The Capital Financing Requirement (CFR) is the total 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 new capital expenditure, which has not immediately been paid for, will increase the CFR.
25. The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.
26. The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a funding facility and so the Council is not required to borrow separately for them. The Council currently has £17m of such schemes within the CFR.
27. CFR projections are included in the table below.

Table 2 Capital Financing Requirement

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
CFR as at 31 March					
Non – HRA	268,264	316,762	413,029	639,035	639,120
HRA	149,477	152,541	154,701	154,685	154,669
TOTAL	**417,741**	**469,303**	**567,730**	**793,720**	**793,789**
Movement in CFR	**13,363**	**51,562**	**98,427**	**225,990**	**69**

Movement in CFR represented by					
Net financing need for the year	28,689	64,397	113,293	241,841	17,669
Less Minimum/Voluntary revenue provision and other financing movements	15,326	12,835	14,866	15,851	17,600
Movement in CFR	**13,363**	**51,562**	**98,427**	**225,990**	**69**

The Non-HRA CFR increases over the five years from £268m to £639m reflecting the regeneration programme, the property investment portfolio, secondary school expansion, the redevelopment of the depot, the renewal and replacement of highways, footways and streetlighting and upgrades and enhancements to ICT systems. Through a special determination the debt limit for the HRA has been increased to £154.7m and work will be carried out in line with this increase.

2.3 Minimum Revenue Provision (MRP) Policy Statement

28. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.

29. Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) require the Council to approve an MRP Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits. The Council is recommended to approve the statement as detailed in Appendix C.

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.

2.4. Core funds and expected investment balances

31. The application of resources (grants, capital receipts etc.) to finance capital expenditure or budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

3. BORROWING

32. The capital expenditure programme set out in Paragraph 23 provides 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 the activities of the Council. This involves both the organisation of the cash flow and, where the capital programme requires it, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current and estimated portfolio position

33. The Council's borrowing position at 31 December 2016 is summarised below.

Table 3 Summary Borrowing and Investment Position at 31 December 2016

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	218.5		
	Market	116.0	334.5	4.24
Variable rate funding			0	
Other long term liabilities (PFI & leases)			17.0	
Total Debt			351.5	
Total Investments at 31.12.2016			76.1	0.33

34. The Council has borrowed £70.8m under Lender Option, Borrower Option (LOBO) structures with maturities between 2050 and 2077. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and half yearly thereafter) to reset the interest rate. If the rate of interest changes, the Council is permitted to repay the loan at no additional cost.

35. The Council's borrowing position with forward projections is summarised below. The table shows the actual external debt, against the underlying capital borrowing need, highlighting any under or over borrowing.

36. The expected change in debt in 2017/18, 2018/19 and 2019/2020 reflects the anticipated borrowing necessary to meet the capital programme described in Table 1.

37. Debt outstanding should not exceed CFR.

Table 4 Changes to Gross Debt

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
External Debt					
Debt at 1 April	334,434	334,434	334,434	447,727	689,568
Expected change in Debt	-	-	113,293	241,841	17,669
Other long-term liabilities (OLTL) 1st April	18,075	17,032	16,000	15,000	14,000
Expected change in OLTL	- 1,043	- 1,032	- 1,000	- 1,000	- 1,000
Actual gross debt at 31 March	351,466	350,434	462,727	703,568	720,237
Capital financing requirement	417,741	469,303	567,730	793,720	793,789
Under / (Over) borrowing	**66,275**	**118,869**	**105,003**	**90,152**	**73,552**

38. 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.

39. The Director of Finance 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 programmes and the proposals in the budget report.

40. The table below shows the net borrowing after investment balances are taken into account.

Table 5 Net Borrowing

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Gross Borrowing brought forward 1 April	352,509	351,466	350,434	462,727	703,568
Changes to Gross Borrowing	-1,043	-1,032	112,293	240,841	16,669
Carry Forward 31st March	**351,466**	**350,434**	**462,727**	**703,568**	**720,237**
Investment brought forward 1 April	119,078	76,233	30,000	30,000	30,000
Changes to Gross Investments	-42,845	-46,233	0	0	0
Carry Forward 31st March	**76,233**	**30,000**	**30,000**	**30,000**	**30,000**
Total Net Borrowing	**275,233**	**320,434**	**432,727**	**673,568**	**690,237**
Change in net borrowing	**41,802**	**45,201**	**112,293**	**240,841**	**16,669**

The change in net borrowing in 2016/17 arises mainly from the reduction in cash balances of £46m and in subsequent years from additional borrowing.

3.2 Treasury indicators: limits to borrowing activity

The Operational Boundary

41. This is the limit which external debt is not normally expected to exceed.

42. The boundary is based on the Council’s programme for capital expenditure, capital financing requirement and cash flow requirements for the year.

The Authorised Limit for External Debt.

43. This is a further key prudential indicator which represents a control on the maximum level of borrowing. It represents a limit beyond which external debt is prohibited. It relates to the financing of the capital programme by both external borrowing and other forms of liability, such as credit arrangements.

44. 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’ programmes, or those of a specific council, although this power has not yet been exercised.

Table 6 Operational boundary and authorised limit

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Authorised Limit for external debt					
Borrowing and finance leases	418	469	568	794	794
Operational Boundary for external debt					
Borrowing	340	334	448	690	707
Other long term liabilities	17	16	15	14	13
Total	357	350	463	704	720
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing	340	334	448	690	707
Upper limit for variable rate exposure					
Net principal re variable rate borrowing	-	-	-	-	-
Upper limit for principal sums invested over 364 days	41	60	60	60	60

Due to the Council's current under borrowing position it is considered sufficient to set the Authorised limit at the same level as the CFR.

As shown in Table 10 in Appendix F below, the Council may wish to make additional investments of over 364 days. The current limit for such investments is £41m. To respond to potential new initiatives it is recommended that at this stage the limit for investments over 364 days be set at £60m.

HRA Debt Limit

45. Separately, the Council is also limited to a maximum HRA debt through the HRA self-financing regime. This limit and the HRA CFR are shown in the table below.

Table 7 HRA Debt Limit and CFR

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
HRA Debt Limit	151.34	154.84	154.84	154.84	154.84
HRA CFR	149.48	152.54	154.70	154.69	154.67
Headroom	**1.86**	**2.30**	**0.14**	**0.16**	**0.17**

3.3 Prospects for interest rates and economic commentary

46. The Treasury Management Adviser has provided a commentary on the prospects for interest rates included as Appendix D and an economic commentary included as Appendix E.

3.4 Borrowing strategy

47. As shown in Table 4 above, currently the Council has a debt portfolio of £350m, mainly long term, with an average maturity of 35 years assuming no early repayment of the LOBO loans. Adjusting LOBO loans maturity in line with the next interest reset date reduces the average maturity to 25 years. Cash balances at 31 December 2016 were £76.1m. With the investment portfolio yielding only 0.33% and the likely average cost of new debt 2.6%, there is a substantial short term cost of carrying excessive debt.

48. As shown in Table 4 above the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary source of funding. This strategy is prudent with investment returns low and counterparty risk is still an issue to be considered.

49. However, with the reduction in cash balances and the likelihood that they will be further reduced by the end of 2016/17 much of the increased capital programme in the next few years will need to be funded from borrowing. As shown in Table 4 above, it is currently estimated that sums of £113m, £242m and £18m will need to be borrowed in the next three years. The Council will have a range of funding sources available and will need to base its decisions on optimum borrowing times and periods taking into account current interest rates and likely future movements and the "cost of carry" (difference between rates for borrowing and rates for investments) which currently remains high. A strategy is being developed in consultation with the Treasury Management Adviser. It is also possible, but unlikely, that new long term borrowing in the next three years might be required if part of the LOBO portfolio has to be refinanced early.

50. It may be necessary to resort to temporary borrowing from the money markets or other local authorities to cover mismatches in timing between capital grants and payments. However, with several Government grants now paid early in the financial year this is not very likely.

51. Against this background and the risks within the economic forecast, caution will be adopted in the 2017/18 treasury management operations. The Director of Finance 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 start date and 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.

52. The Council has adopted a single pooled approach for debt. Allocations to HRA are based on its CFR, with interest charged to HRA at the average rate on all external borrowing. Longer term, the HRA's ability to repay borrowing will depend on future revenues and the capital expenditure programme.

3.5 Treasury management limits on activity

53. There are three debt related treasury activity limits. The purpose of these is 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 and improve performance.

Upper limit on variable interest rate exposure

54. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. As shown in Table 6 above the Council does not expect to undertake any borrowing on this basis.

Upper limit on fixed interest rate exposure

55. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments. The Council's proposed limits are shown in Table 6 above

Maturity Structure of Borrowing

56. 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.
57. The Council has no variable rate borrowing and the comments below relate only to its fixed rate portfolio.
58. In the table below, the maturity structure for the LOBO debt, in accordance with CIPFA Guidance, is shown as the first date that the interest rate can be increased.

Table 8 Maturity Structure of Fixed Rate Borrowing

	As at 31.12.2016 %	Upper limit %	Lower limit %
Under 12 months	24	30	0
12 months to 23 months	0	20	0
24 months to under 5 years	7	30	0
5 years to under 10 years	1	40	0
10 years and over	68	90	30

3.6 Policy on borrowing in advance of need

59. 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 CFR estimates and future authorised limits, 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.

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

3.7 Debt rescheduling

61. Capita currently advise that:

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).

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;*
- *enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).*

62. Opportunities to reduce the cost of debt by premature repayment or to improve the maturity profile are kept under review in discussion with the Treasury Management Adviser. Early repayment of market loans is by negotiation. For PWLB loans, there are daily published prices for early repayment that allows analysis of the opportunities for restructuring. There is currently a spread which has generally made restructuring uneconomic.

63. During June 2017 historic borrowings of £10m are due for repayment. These maturities will be met either from cash balances available at the time or from replacement borrowing.

64. Should any of the LOBO loans with interest rate reset dates in 2017-18 (£70.8m) require refinancing, the most likely source would be external borrowing.

65. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

4. Annual Investment Strategy

4.1 Investment policy

66. The Council's investment policy has regard to the Department for Communities and Local Government Investment Guidance and the CIPFA Treasury Management Code. The Council's investment priorities will be security first, liquidity second, then return.

67. Advice received from Capita is:

We remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. However, we also have a very accommodating monetary policy - reflected in a 0.25% Bank Rate. As a consequence, authorities are not getting much of a return from deposits. Against this backdrop it is, nevertheless, easy to forget recent history, ignore market warnings and search for that extra return to ease revenue budget pressures. In this respect, we are seeing an increase in investment "opportunities" being offered to clients or being discussed in the wider press. What then, should you consider when these are offered?

We suggest that you "look under the bonnet" when considering pooled investment vehicles, although this applies to any investment opportunity. It is not enough that other councils are investing in a scheme or an investment opportunity: you are tasked through market rules to understand the "product" and appreciate the risks before investing. A quote from the Financial Conduct Authority puts the environment in context.

The main risks in the industry for the coming year are firms designing products that: -

- *aren't in the long-term interest of consumers*
- *don't respond to their needs*
- *encompass a lack of transparency on what's being sold*
- *lead to a poor understanding by consumers of risk*
- *shift toward more complex structured products that lack oversight.*

68. In accordance with the above guidance and in order to minimise the risk to investments, the Council in Appendix F clearly stipulates the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. The Treasury Management Adviser monitors counterparty ratings on a real time basis with knowledge of any changes advised electronically as the agencies notify modifications.

69. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually 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 Adviser to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

70. The aim of the strategy is to generate a list of highly creditworthy counterparties which will provide security of investments, enable divesification and minimise risk.

71. Investment instruments identified for current use are listed in Appendix F under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices.

4.2 Creditworthiness policy

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

    - 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
    - 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.

73. The Director of Finance 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 those which determine which types of investment instrument are either specified or non-specified as they provide 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.

74. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council’s criteria, the other does not, the institution will fall outside the lending criteria.

75. Credit rating information is supplied by the Treasury Management Adviser on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty 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.

76. The Council’s criteria for an institution to become a counterparty are detailed in Appendix F.

4.3 Country Limits

77. The Council has determined that it will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AAA. Currently the only countries meeting this criterion are Australia, Canada, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden and Switzerland. The current UK rating is the third level of AA. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Annual Investment Strategy

78. **In-house funds.** The Council's funds are mainly cash derived primarily from the General Fund and HRA. Balances are also held to support capital expenditure. From 1st April 2011, pension fund cash balances have been held separately from those of the Council. However, a separate investment strategy has not been developed for the pension fund and all its cash is held on overnight call account with RBS. Investments are 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).

79. **Investment returns expectations.** Bank Rate is forecast by Capita 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 are:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%

80. Capita suggest that budgeted investment earnings rates for returns on investments placed for periods of up to 100 days during each financial year are as follows:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

81. Capita further advise that "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 indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. The Council's limit for investments of over 364 days is currently £40.5m and Cabinet will be asked to approve an increase to £60m to take into account the purchase of homes by the Housing Development Vehicle.

83. Throughout 2016-17 interest rates receivable for short term investments have fallen substantially with the Council currently receiving 0.20% compared to 0.40% at the beginning of the year for deposits of under one month. The Council's bankers also reduced the call account rate from 0.25% to 0.01% in December.

84. As a consequence of these rates and the maturity of several higher yielding investments the Council's return for the whole year is likely to be close to 0.3%. Whilst this is still above the short term LIBOR benchmark and comparable to peer authorities it represents a substantial reduction from rates earned in recent years.

85. As a result of the Council's strategy and the interest rates available the only counterparties actively in use during 2016-17 have been Lloyds, Royal Bank of Scotland Group and Svenska Handelsbanken. The investment portfolio has inevitably remained concentrated with RBS and Lloyds with 78.3% of the total portfolio invested with them on 31st December 2016. When opportunities arise consistent with the Council's policies diversification will be sought but it is not anticipated that there will be any significant change during 2017-18.

4.5 Investment risk benchmarking

86. This Council uses the current LIBOR rates as a benchmark to assess the investment performance of its investment portfolio. In addition the Council is a member of a Capita investment portfolio benchmarking group through which performance is measured against peer London authorities. The risk of default attached to the Council's portfolio is reported by Capita on a monthly basis.

4.6 End of year investment report

87. At the end of the financial year the Council will report on its investment activity as part of the Treasury Management Outturn Report.

5. Affordability Prudential Indicators

88. The previous sections cover the overall capital and control of borrowing Prudential Indicators but within this framework Prudential Indicators are also required to assess the affordability of the capital investment programme. These provide an indication of the impact of the programme on the Council's overall finances and are shown in detail in Appendix G.

6. Legal Implications

89. The purpose of this report is to comply with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and other relevant guidance referred to in the report.

7. Financial implications

90. Financial matters are integral to the report.

8. Risk management implications

91. The identification, monitoring and control of risk are central to the achievement of treasury management objectives and to this report. Potential risks are identified, mitigated and monitored in accordance with Treasury Management Practice Notes approved by the Treasury Management Group.

92. Risks are included in the Directorate Risk Register.

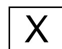
9. Equalities implications

93. Officers have considered possible equalities impact and consider that there is no adverse equalities impact as there is no direct impact on individuals

10. Corporate priorities

94. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert Date: 20 January 2017	 X	Director of Finance
Name: Caroline Eccles Date: 20 January 2017	X	on behalf of the Monitoring Officer

Ward Councillors notified:	No
EqIA carried out: EqIA cleared by:	No N/A

Section 4 - Contact Details and Background Papers

Contact: **Ian Talbot** (Treasury and Pension Fund Manager) Tel: 020-8424-1450 /
Email: ian.talbot@harrow.gov.uk

Background Papers: None

APPENDIX A

LEGISLATION AND REGULATIONS IMPACTING ON TREASURY MANAGEMENT

The following items numbered 1 - 4 show the sequence of legislation and regulation impacting on the treasury management function. The sequence begins with primary legislation, moves through Government guidance and Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice and finishes with implementation through the Council's own Treasury Management Practices.

1. Local Government Act 2003

Link below

Local Government Act 2003

Below is a summary of the provisions in the Act dealing with treasury management.

In addition the Secretary of State is empowered to define the provisions through further regulations and guidance which he has subsequently done through statutory instruments, Department of Communities and Local Government Guidance and CIPFA codes of practice.

Power to borrow
The Council has the power to borrow for purposes relevant to its functions and for normal treasury management purposes – for example, to refinance existing debt.

Control of borrowing
The main borrowing control is the duty not to breach the prudential and national limits as described below.
The Council is free to seek loans from any source but is prohibited from borrowing in foreign currencies without the consent of Treasury, since adverse exchange rate movements could leave it owing more than it had borrowed.
All of the Council's revenues serve as security for its borrowing. The mortgaging of property is prohibited.
It is unlawful for the Council to 'securitise', that is, to sell future revenue streams such as housing rents for immediate lump-sums.

Affordable borrowing limit
The legislation imposes a broad duty for the Council to determine and keep under review the amount it can afford to borrow. The Secretary of State has subsequently defined this duty in more detail through the Prudential Code produced by CIPFA, which lays down the practical rules for deciding whether borrowing is affordable.
It is for the Council (at a meeting of the full Council) to set its own 'prudential' limit in accordance with these rules, subject only to the scrutiny of its external auditor. The Council is then free to borrow up to that limit without Government consent. The Council is free to vary the limit during the year, if there is good reason.

Requirements in other legislation for the Council to balance its revenue budget prevents the long-term financing of revenue expenditure by borrowing.

However the legislation does confer limited capacity to borrow short-term for revenue needs in the interests of cash-flow management and forseeable requirements for temporary revenue borrowing are allowed for when borrowing limits are set by the Council.

The Council is allowed extra flexibility in the event of unforeseen needs, by being allowed to increase borrowing limits by the amounts of any payments which are due in the year but have not yet been received.

Imposition of borrowing limits
The Government has retained reserve power to impose 'longstop' limits for national economic reasons on all local authorities' borrowing and these would override authorities' self-determined prudential limits. Since this power has not yet been used the potential impact on the Council is not known.

Credit arrangements
Credit arrangements (eg property leasing, PFI and hire purchase) are treated like borrowing and the affordability assessment must take account not only of borrowing but also of credit arrangements. In addition, any national limit imposed under the reserve powers would apply to both borrowing and credit.

Power to invest
The Council has the power to invest, not only for any purpose relevant to its functions but also for the purpose of the prudential management of its financial affairs.

2. Department for Communities and Local Government Investment Guidance (March 2010)

The Local Government Act 2003 requires a local authority "…..to have regard (a) to such guidance as the Secretary of State may issue………….." and the current guidance became operative on 1 April 2010.

The Guidance recommends that for each financial year the Council should prepare at least one investment Strategy to be approved before the start of the year. The Strategy must cover:

- **Investment security**

  Investments should be managed prudently with security and liquidity being considered ahead of yield

  Potential counterparties should be recognised as "specified" and "non-specified" with investment limits being defined to reflect the status of each counterparty

- **Investment risk**

  Procedures should be established for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.

  The use of credit ratings and other risk assessment processes should be explained

  The use of external advisers should be monitored

  The training requirements for treasury management staff should be reviewed and addressed

  Specific policies should be stated as regards borrowing money in advance of need

- **Investment Liquidity**

  The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed

The Strategy should be approved by the full Council and made available to the public free of charge. Subject to full Council approval, or approved delegations, the Strategy can be revised during the year.

3. Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA 2011)

The primary requirements of the Code are:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the full Council or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

4. The Prudential Code for Capital Finance in Local Authorities (CIPFA 2011) – Guidance 2013

Compliance with the objectives of the Code by the Council should ensure that:

- Capital expenditure plans are affordable in terms of their implications on Council Tax and housing rents
- External borrowing and other long term liabilities are within prudent and sustainable levels
- Treasury management decisions are taken in accordance with good professional practice

As part of the two codes of practice above the Council is required to:

- agree a series of prudential indicators against which performance is measured
- produce Treasury Management Practice Notes for officers which set out how treasury management policies and objectives are to be achieved and activities controlled.

APPENDIX B

TREASURY MANAGEMENT DELEGATIONS AND RESPONSIBILITIES

The respective roles of the Council, Cabinet, GARMSC, the Section 151 officer, the Treasury Management Group the Treasury and Pension Fund Manager and the Treasury Team are summarised below. Further details are set out in the Treasury Management Practices.

Council

Under the Constitution, the Council is responsible for "decisions relating to the control of the Council's borrowing requirement."

It agrees the annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy.

Cabinet

Under the Constitution, the Cabinet "will exercise all of the local authority functions which are not the responsibility of any other part of the local authority, whether by law or under this Constitution."

It considers and recommends to Council the annual Treasury Management Strategy Statement and receives a mid-year report and annual outturn report on Treasury Management activities.

Governance, Audit, Risk Management and Standards Committee

GARMSC reviews the Treasury Management Strategy and monitors progress on treasury management in accordance with CIPFA codes of practice.

Director of Finance (Section 151 Officer)

Under S151 of the Local Government Act 1972 the Council "shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs." At Harrow, this responsibility is exercised by the Director of Finance.

The Director is responsibility for implementing the policies agreed by the Council and Cabinet.

Under the Local Government Finance Act 1988 and the Local Government Act 2003 the Director also has responsibilities in respect of budget arrangements and the adequacy of resources. In terms of Treasury Management this means that the financing costs of the

Capital Programme are built into the Revenue Budget as are any assumptions on investment income.

The Director chairs the Treasury Management Group and agrees major treasury management decisions, specifically including any borrowing decisions, delegated to officers.

Treasury Management Group

Comprises Director of Finance, Head of Strategic and Technical Finance (Deputy S151 Officer), Treasury and Pension Fund Manager, Senior Finance Officer and is responsible for:

- Monitoring treasury management activity against approved strategy, policy, practices and market conditions;
- Ensuring that capital expenditure plans are continually reviewed in line with budget assumptions throughout the year to forecast when borrowing will be required.
- Approving changes to treasury management practices and procedures;
- Reviewing the performance of the treasury management function using benchmarking data on borrowing and investment provided by the Treasury Management Adviser (Capita Asset Services);
- Monitoring the performance of the appointed Treasury Management Adviser and recommending any necessary actions
- Ensuring the adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function;
- Monitoring the adequacy of internal audit reviews and the implementation of audit recommendations

Treasury and Pension Fund Manager

Responsible for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Management Strategy Statement and CIPFA's "Standard of Professional Practice on Treasury Management"

Treasury Team

Headed by Senior Finance Officer with responsibility for day-to-day treasury and investment and borrowing activity in accordance with approved Strategy, policy, practices and procedures and for recommending changes to the Treasury Management Group

APPENDIX C

Minimum Revenue Provision (MRP) Policy Statement

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be the equal annual reduction of 2% of the outstanding debt at 1 April 2015 for the subsequent 50 years.

- For all capital expenditure financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon an asset life method in accordance with Option 3 of the guidance.

- In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.

- A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts.

- Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

- Freehold land cannot properly have a life attributed to it, so for the purposes of Asset Life method it will be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate will be used for the land.

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

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

- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

- Under Treasury Management best practice the Council may decide to defer borrowing up to the capital financing requirement (CFR) and use internal resources instead. Where internal borrowing has been used, the amount chargeable as MRP may be adjusted to reflect the deferral of actual borrowing.

APPENDIX D

Provided by Capita Asset Services at 20 December 2016

Interest Rate Forecasts 2016 - 2020

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 our central view.

	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%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

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

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling

bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

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

Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
    - Italian constitutional referendum 4.12.16 resulted in a ‘No’ vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
    - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
    - Dutch general election 15.3.17;
    - French presidential election April/May 2017;
    - French National Assembly election June 2017;
    - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.

- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. 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 later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

APPENDIX E

Provided by Capita Asset Services at 20 December 2016

Economic Background

United Kingdom

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.

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.

The Monetary Policy Committee, (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The MPC meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards,

though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

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. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

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 just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation 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.

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 has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and core inflation was 1.4%, confirming the likely future upwards path.

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 hit a new peak on the way up again of 1.55% on 15 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.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October.The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

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, quarter 3 at 3.2% 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 of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. 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. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

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.

Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a 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.

In the first week since the US election, there was a 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 could 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.

Eurozone

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%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% 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.

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

- 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.

- Spain has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.

- 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'.

- 4 December Italian constitutional referendum on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.

- Dutch general election 15.3.17; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.

- French presidential election; first round 13 April; second round 7 May 2017.

- French National Assembly election June 2017.

- German Federal election August – 22 October 2017. This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.

- The core EU, (note, not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Asia

Economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in Japan is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries

There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels

Brexit timetable and process

As understood in December 2016 the Brexit timetable and process is proposed as follows:

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50

- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.

- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.

- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.

- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.

- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

APPENDIX F

Counterparties

Specified Investments
These are sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the lender has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. The instruments and credit criteria to be used are set out in the table below.

Table 9 Specified Investments

Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1+Short-term 2 Support UK or AAA Sovereign	In-house
Money Market Funds	AAA	In-house

Non-Specified Investments
Non-specified investments are any other type of investment (i.e. not defined as Specified above).They normally offer the prospect of higher returns but carry a higher risk. The identification and rationale supporting the selection of these other investments are set out in the table below.

Table 10 Non - Specified Investments

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
Term deposits – banks and building societies (excluding Lloyds / HBOS)	A Long Term F1 Short-term UK or AAA Sovereign	In-house	50%	3 months
Lloyds / HBOS	A Long Term F1 Short-term	In-house	50%	6 months
Callable Deposits	A Long Term F1 Short term	In-house	20%	3 months
UK nationalised Banks [RBS]	F2 Short-term	In-house	60%	36 months
Enhanced Cash Funds	AAA	In-house	25% (maximum £10 million per fund)	Minimum monthly redemption
Corporate bonds pooled funds, other non-standard investments and gilts		In house	£10m in total	Dependent on specific agreement
HB Public Law Ltd		In house	£0.1m	36 months

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
Investment Property Strategy *		In house	£20.0m	Dependent on specific agreement
Concilium Business Services Ltd t/a Smart Lettings Ltd		In house	£0.274m	36 months
Concilium Group Startup capital		In house	£0.702m	60 months
Concilium Group 5% Long Term Investment		In house	£1.5m	Dependent on specific agreement
Cultura London re Harrow Arts Centre		In house	£1m	25 years
Housing Development Vehicle (LLP) – Initially on acquisition of 100 homes		In house	£30m	Dependent on specific agreement

*Investment to date totals £5.3m

APPENDIX G

Affordability Prudential Indicators

1 Ratio of Financing Costs to Revenue Stream

This indicator identifies the trend in the cost of capital (borrowing, depreciation, impairment and other long term obligation costs net of investment income) against the net revenue stream. Tables 11 and 12 below show the current position for the General Fund and HRA respectively.

Table 11 Ratio of Financing Costs to Revenue Stream – General Fund (excluding Regeneration)

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
Net revenue stream (£'000)	164,794	164,987	162,955	156,106	151,148
Interest costs (£'000)	7,866	7,724	8,212	10,229	10,566
Interest costs - finance leases (£'000)	1,766	1,700	1,700	1,700	1,700
Interest and investment income (£'000)	-1,817	-1,332	-1,300	-1,300	-1,300
MRP (£'000)	15,326	12,835	14,866	15,851	17,600
Total financing costs (£'000)	23,141	20,927	23,478	26,480	28,566
Ratio of total financing costs against net revenue stream (%)	14.0	12.7	14.4	17.0	18.9

The ratio of total financing costs against net revenue stream increases significantly between 2016-17 and 2019-20 due to the impact of the capital programme and the increase in MRP.

Table 12 Ratio of Financing Costs to Revenue Stream – HRA

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
Gross revenue stream (£'000)	32,111	32,306	32,056	31,943	32,161
Interest costs of self-funding borrowing (£'000)	3,078	3,752	3,752	3,752	3,752
Interest costs of other borrowing (£'000)	3,265	2,699	2,763	2,809	2,808
Interest and investment income (£'000)	-156	-51	0	0	0
Depreciation (£'000)	7,789	6,570	7,314	7,321	7,292
Impairment (£'000)	177	0	0	0	0
Total financing costs (£'000)	14,153	12,970	13,829	13,882	13,852
Ratio of total financing costs against gross revenue stream (%)	44.1	40.1	43.1	43.5	43.1
Ratio of total financing costs (excluding depreciation and impairment) against net revenue stream (%)	19.3	19.8	20.3	20.5	20.4

The ratio of total financing costs against gross revenue stream falls substantially between 2015-16 and 2016-17 and subsequently rises mainly due to the effect on depreciation charges of the self-financing transitional measures.

The ratio of total financing costs (excluding depreciation and impairment) against net revenue stream shows a gradual increase due largely to the mandatory reduction in dwelling rent and the reduction of interest income due to reducing balances on the revenue account and Major Repairs reserve.

2 Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents

This indicator identifies the revenue costs associated with proposed capital programme and the impact on Council Tax and Housing Rents.

Table 13 Incremental Impact of Capital Investment Decisions (excluding Regeneration) – Council Tax

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Net Financing need (£'000)	26,287	52,498	67,163	43,971	27,778
Borrowing @ 25-50years PWLB rate (£'000)	854	1,412	2,040	1,402	885
MRP @ 2% (£'000)	526	1,050	1,343	879	556
Total increased costs (£'000)	**1,380**	**2,462**	**3,383**	**2,281**	**1,441**
Ctax base (£'000)	79,795	82,000	83,500	83,500	83,500
% Increase	1.7	3.0	4.1	2.7	1.7
Band D Council Tax	1,529	1,560	1,560	1,560	1,560
Overall increase £ pa	**26.44**	**46.84**	**63.21**	**42.62**	**26.92**

The financing of the Regeneration project is discussed in detail in the report to Cabinet of 19 January 2017.

Table 14 Incremental Impact of Capital Investment Decisions – Housing Rents

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Net Financing need (£'000)	-	-	-	-	-
Borrowing @ 25-50years PWLB rate (£'000)	-	-	-	-	-
Depreciation @ 2% (£'000)	-	-	-	-	-
Total increased costs	-	-	-	-	-
Number of dwellings	4,867	4,840	4,879	4,874	4,839
Increase in average housing rent per week £	**-**	**-**	**-**	**-**	**-**

3 Local HRA indicators

The Council should also be aware of the following ratios when making its treasury management decisions.

Table 15 HRA Ratios

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt (CFR) (£m)	149.48	152.54	154.70	154.69	154.67
Gross Revenue Stream (£m)	32.11	32.31	32.06	31.94	32.16
Ratio of Gross Revenue Stream to Debt (%)	**21**	**21**	**21**	**21**	**21**
Average Number of Dwellings	4,867	4,847	4,860	4,877	4,857
Debt outstanding per dwelling (£)	**30,712**	**31,471**	**31,831**	**31,717**	**31,845**

Rents in the Housing Revenue Account are projected to reduce by 1% each year for four years commencing in 2016/17, in line with the provisions of the Welfare Reform and Work Act. The reduction in income is expected to be mitigated over the next two years by additional rent income generated as a result of an increase in HRA property numbers from the Council's HRA new build and purchase and repair programmes.