TREASURY MANAGEMENT STRATEGY STATEMENTS, MRP STRATEGY AND ANNUAL INVESTMENT STRATEGY 2017/18

1. Introduction

1.1 The council is required to operate a balanced budget and in pursuit of this objective, the council operates a treasury management function which incorporates the management of the council's cash flows, lending and borrowing activities and the control management and mitigation of the risks associated with these activities. The borrowing facilitates the funding of the council's capital programme.

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

1.3 The Local Government Act 2003 (the Act) and supporting regulations requires the council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code (Prudential Code) and the CIPFA Treasury Management Code of Practice (Treasury Code) to set prudential and treasury indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable.

1.4 In pursuit of the above the council must produce as a minimum three key reports:

- Treasury Strategy, prudential and treasury indicators, a requirement fulfilled by the production of this report. The report covers:
  - capital plans (including prudential indicators),
  - minimum revenue provision (MRP) policy ,
  - the treasury management and investment strategy.
- A mid-year report which updates members on treasury progress, the capital position, the prudential indicators and whether any strategies or policies require revision.
- An annual treasury outturn report.

1.5 Council approves the Treasury Strategy as part of the annual budget-setting process. This appendix sets out the Treasury Strategy for 2017/18.

1.6 The scrutiny of the treasury management function within the council is undertaken by Audit Committee, who carry out quarterly reviews.

1.7 The council is also required to comply with investment guidance issued by the Department of Communities and Local Government which came into effect from 1 April 2010. The council's investment strategy is compliant with the CLG guidance.

1.8 The Treasury Code (revised November 2011) was adopted by Council on the 9 March 2010. This strategy report complies with the revised Code of Practice.

1.9 In addition to the reporting schedule outlined above the code requires the:

- Creation and maintenance of a treasury management policy statement which sets out the policies and objectives of the council's treasury management activities. The Treasury Management Policy Statement is attached for reapproval as Annex 1.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the council will seek to achieve those policies and objectives; these are maintained and kept under review by officers.
- 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. The scheme of delegation is attached as Annex 2.

1.10 The council complies with the above and its governance process is strengthened by its Treasury Risk and Investment Board (TRIB), which meets regularly to support the Director of Finance in the execution of their delegated powers.

2. Treasury Management Strategy for 2017/18

2.1. The Strategy for 2017/18 addresses capital plans, prudential indicators, minimum revenue provision (MRP) and other treasury management issues such as the investment strategy and creditworthiness policy.

2.2. The proposed Treasury Management Strategy and Policy for the remainder of 2015/17 and for financial year 2017/18 adheres to the council's policy on investments of "safety before returns" and investments are currently being placed with the following:

- The UK government directly (Debt Management Office)
- Lloyds and RBS (because of the UK government's stake in these institutions), though the officers are cognisant of the reducing stake in Lloyds and have been responding to the government's ongoing disinvestment.
- The council's banker (Lloyds Bank)
- HSBC
- Nationwide
- Barclays; and
- Other local authorities
- Money Market Funds

2.3. The strategy proposed in this report will assist the council in mitigating risk in the council's treasury management activities and allow the borrowing necessary to finance the capital programme.

2.4. The proposed strategy for 2017/18 is based upon treasury officers' views on interest rates based, market forecasts acquired directly by council officers and supplemented by forecasts provided by the council's treasury advisors, Capita Asset Services.

2.5. The strategy report covers:

- Update on Pension Fund and West London Waste Authority cash (para 2.9 to 2.13)
- Capital Plans and Prudential Indicators (para 3 and Annex 3)
- Minimum Revenue Provision (MRP) Policy (para 4 and Annex 1)
- Borrowing (para 5)
- Treasury Limits for 2016/17 to 2018/19 (para 6)
- Economic Background (para 7)
- Borrowing Strategy including borrowing in advance of need (para 8)
- Debt Rescheduling (para 9)
- Housing Revenue Account (HRA) Self Financing (para 10)
- Annual Investment Strategy (para 11 and Annex 5)
- Financial Implications (para 12)
- Balanced Budget Requirement (para13)
- Treasury Management Policy Statement (Annex 1)
- Scheme of Delegation (Annex 2)
- Prudential Indicators (Annex 3)
- MRP Policy (Annex 4)

2.6. These factors embrace the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Code and CLG Investment Guidance.

Training

2.7. The Treasury Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training on treasury management and related issues. This especially applies to members responsible for scrutiny, who regularly receive training on the subject by the council. Audit Committee members last received targeted training on the 29 November 2016. The training needs of treasury management officers are met through attendance at relevant courses, conferences and forums and are periodically reviewed and addressed as part of the council's appraisal scheme.

Treasury Management Consultants

2.8. The council uses Capita Asset Services, Treasury solutions as its external treasury management advisors. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Pension Fund Cash

2.9. The council's arrangement for pension fund cash changed from 1 April 2011 to meet the requirements of CLG regulations. A separate bank account is operated for the pension fund and pension fund cash continues to be invested separately from the council's in either special interest bearing accounts or as fixed term deposits with counterparties on the council's counterparty list. Most of the excess Pensions Fund cash is transferred monthly to the Custodian's (BNY Mellon) bank account where it is swept for overnight investment into a money market bank account.

2.10. The council is responsible for managing the pension fund cash that (that may remain in house) in accordance with this Treasury Management Strategy. The Pension Fund Panel is updated of progress on a quarterly basis.

West London Waste Authority (WLWA) Cash

2.11. From 1 April 2014, the London Borough of Ealing started to carry out treasury management services for the WLWA. There are significant benefits in the WLWA engaging with one of the boroughs to provide treasury management services on their behalf.

2.12. During 2016/17 WLWA transferred their excess funds to the council to be invested jointly. They will earn the average interest rate achieved by the council based on their average balance. The WLWA has also subscribed to Capita Asset Management Services and they will mirror the council's investment strategy.

2.13. The performance of the treasury management service will be reviewed on an annual basis. The annual charge for the WLWA using Ealing's treasury management services has been agreed for 2017/18 at £7,000 and the current service contract will run to 2017/18.

3. Prudential Indicators

3.1. The Local Government Act 2003 and supporting regulations requires the council to ‘have regard to’ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the council’s capital investment plans are affordable, prudent and sustainable.

3.2. Ealing’s Prudential Indicators for the period 2016/17 – 2020/21 are set out in Annex 3 and council is asked to approve these.

3.3. The benefit of the indicators will be derived from monitoring them over time rather than from the absolute value of each. A reporting process has been established, with a half-yearly report to council to highlight any significant deviations from expectations. The indicators can be amended, and reported to council for approval at the earliest opportunity.

3.4. The indicators for later years are broad estimates since a number of factors including the level of government support beyond 2017/18 are unconfirmed. These estimates will be revised, as more accurate information becomes available.

4. Minimum Revenue Provision (MRP) Policy Statement

4.1 The council is required to pay off an element of the accumulated general fund capital spend funded by borrowing each year (the Capital Financing Requirement - CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

4.2 CLG Regulations require the council to approve **an MRP Statement** in advance of each year. The council has discretion to choose from a number of recommended options for the calculation of the MRP, or to formulate its own methodology so long as the adopted option represents a prudent provision. The council is recommended to approve the following MRP Statement which is in accordance with CLG guidance.

4.3 The Guidance issued by the CLG provides four options which can be used for the purpose of calculating the MRP:

- Option 1 - Regulatory Method
- Option 2 - Capital Financing Requirement Method
- Option 3 - Asset Life Method
- Option 4 - Depreciation Method

4.4 The policy already in place in the council is reflected in Options 1 and 3. However Officers are putting forward a revision to the MRP policy to write down the pre 2008 debt moving from a 4% reducing balance to a more prudent 2% straight line basis which will see the debt paid off over 50 years. Details of the rationale for the change are outlined in Annex 4.

4.5 Council is recommended therefore to approve the MRP policy statement as set out in Annex 4.

4.6 It is therefore recommended that in respect of capital expenditure incurred before 1 April 2008, that the Minimum Revenue Provision Policy be revised to:

- *"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 2017 for the subsequent* 50 years"

4.7 Repayments included in annual PFI or finance leases are applied as MRP. There is no requirement for the HRA to set aside MRP, although there is a requirement for depreciation to be applied.

4.8 When making policy investments the council needs to consider the potential MRP implications should the loan be classed as capital spend. The authority will be providing loans on a commercial basis to third parties to facilitate the delivery of housing or services that advance the council's policy objectives. The cash advances will be used by the third parties to fund capital expenditure and should therefore be treated as capital expenditure and a loan to a third party. The capital financing requirement (CFR) will increase by the amount of loans advanced and under the terms of contractual loan agreements are due to be returned in full at a future date, with interest paid. Once funds are returned to the authority, the returned funds are classed as a capital receipt, and off-set against the CFR, which will reduce accordingly. As this is an arrangement that will see the funds returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

4.9 The outstanding loan/CFR position will be reviewed on an annual basis and if the likelihood of default increases, a prudent MRP policy will commence.

Core funds and expected investment balances

4.10 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other 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.). Outlined below are estimates of the year end balances on investments.

Table 1 – Estimate of year End Balance

Year End Resources	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Expected investments	200	160	160	160	160

Affordability Prudential Indicators

4.11 Within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the council's overall finances. Council is asked to approve the indicators as set out in Annex 3.

5. Borrowing

5.1 The capital expenditure plans set out in this appendix outline the service activity for the council. The treasury management function ensures that the council adheres to the relevant treasury codes as well as organising the council's cash flow and borrowing needs to meet the requirements of the service activity. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects are limited to a level which is affordable, prudent and sustainable within the projected income of the council for the foreseeable future.

5.2 The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

5.3 The council's current treasury portfolio position is set out in table 2 below:

Table 2 – Council's treasury portfolio position at 31 December 2016

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
External Debt					
Debt at 1 April	470.616	455.438	444.045	437.343	430.641
Expected change in Debt +/-	(15.178)	(11.393)	(6.702)	(6.702)	(5.027)
Actual gross debt at 31 March	**455.438**	**444.045**	**437.343**	**430.641**	**425.614**
The Capital Financing Requirement (CFR)	**651.132**	**713.287**	**735.686**	**734.284**	**717.614**
Under / (Over) borrowing	**195.694**	**269.242**	**298.343**	**303.643**	**292.000**
Other long-term liabilities (OLTL)	131.493	125.319	120.143	115.186	110.505
Expected change in OLTL	(6.174)	(5.176)	(4.957)	(4.681)	(5.043)
OLTL Total	**125.319**	**120.143**	**115.186**	**110.505**	**105.462**

Note: the table shows the impact of not externally borrowing i.e. using the council's investments to internally fund the council's underlying borrowing and this policy is under constant review.

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

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

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

6.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporating financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit is set out in Annex 3.

7. Economic background and Interest Rate Forecasts

7.1 Capita Asset Services has been appointed as treasury adviser to the council and part of its service is to assist the council to formulate a view on interest rates. The following table outlines the Capita view. It should be noted that the Public Works Loans Board (PWLB) offers a certainty rate discount of 0.20% to local authorities who provide specified information on their plans for capital spending and the associated longer term borrowing. The council has applied and qualifies to borrow at the certainty rate.

Table 3 – Capita Interest Rate Forecast

Rate	Mar-17 %	Jun-17 %	Sep-17 %	Dec-17 %	Mar-18 %	Mar-19 %	Mar-20 %
Bank of England	0.25	0.25	25.00	0.25	0.25	0.25	0.75
5yr PWLB	1.60	1.60	1.60	1.60	1.70	1.80	2.00
10yr PWLB	2.30	2.30	2.30	2.30	2.30	2.50	2.70
25yr PWLB	2.90	2.90	2.90	3.00	3.00	3.20	3.40
50yr PWLB	2.70	2.70	2.70	2.80	2.80	3.00	3.20

7.2 The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August to counteract any negative impact the Brexit vote might have on the UK economy. However, the economic data so far has indicated much stronger growth in the second half 2016 than that forecast; but inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling.

7.3 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.

7.4 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.

7.5 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. 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. 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.

7.6 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.

7.7 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.

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

- Monetary policy tools are dwindling and there may not be enough capacity to central banks respond to future financial crises.
- There are a number of key elections Holland, France and Germany.
- Italy and Spain do not have very stable governments
- The European Sovereign debt issue is not completely behind us
- A number of European banks remain poorly capitalised
- Geopolitical Risks
- Weak growth or recession in the UK'

7.9 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).

8. Borrowing Strategy 2017/18

8.1 Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically 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 council is currently maintaining an under-borrowed position, hence financing schemes through internal borrowing. This means that the capital borrowing need (the Capital Financing Requirement - CFR), has not been fully funded with loan debt as cash supporting the council's reserves, balances and cash flow is being deployed in the interim. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

8.2 In this regards and mindful of the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

8.3 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.

Sensitivities of the forecast

8.4 If Officers' felt there was a significant risk of a sharp fall in long and short term interest rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will continue to be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered. However, if there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be raised whilst interest rates are still lower than they will be in the foreseeable years ahead. Any decisions and actions taken will be reported to Audit Committee or Council at the earliest opportunity.

8.5 The council's borrowing strategy will give consideration to new borrowing in the following order of priority:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned which is currently at historically low rates. However, if the overall forecast for long term borrowing rates were to be a projected increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.
- Temporary borrowing from the money markets or other local authorities
- PWLB variable rate loans for up to 10 years

- Short dated borrowing from non PWLB and other sources
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods across all the durations when rates are seen as being at particularly good value.

8.6 The council will continue to borrow in respect of the following:

- Maturing debt (net of minimum revenue provision).
- Approved unsupported (prudential) capital expenditure.
- To finance cash flow in the short term.

8.7 The type, period, rate and timing of new borrowing will be determined by the Director of Finance under delegated powers, taking into account the following factors:

- Expected movements in interest rates as outlined above.
- Current maturity profile.
- The impact on the medium term financial strategy.
- Prudential indicators and limits.

Treasury Management Limits on borrowing Activity

8.8 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within a flexibly set remit, to managing risk, yet not impose undue restraints that constrain cost reduction or performance improvement. The indicators are:

- Upper limits on variable interest rate exposure net of investments.
- Upper limits on fixed interest rate exposure;
- Maturity structure of borrowing to manage refinancing risk.

8.9 The proposed indicators are set out in Annex 3.

Policy on borrowing in advance of need

8.10 The council needs to ensure that its total debt, does not, except in the short term, exceed the total of the CFR in the preceding year i.e. 2016/17 plus the estimates of any additional CFR for the year 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.

8.11 Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the council can ensure the security of such funds.

8.12 Borrowing in advance of need will be limited to no more than 70% of the expected increase in borrowing need (CFR) over the three year planning period. In determining whether borrowing will be undertaken in advance of need the council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- consider the pros and cons of the impact of borrowing in advance of need at attractive rates on the available cash balances the council will hold and the risks associated with increased exposure to credit risk arising from investing this additional cash in advance of need.

9. Debt Rescheduling

9.1 As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of premiums to be incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

9.2 The reasons for any rescheduling to take place will include: -

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfill the strategy outlined above

- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

9.4 All rescheduling will be reported to Council at the earliest meeting following its implementation.

10. Housing Revenue Account (HRA) Self Financing

10.1 The housing subsidy system was dismantled and replaced by a system of self-financing of the HRA from 1 April 2012.

10.2 Ealing Council received £202.3m from the CLG on the 28 March 2012, which was directly deployed to top slicing the council's portfolio of Public Works Loans Board (PWLB) debt. HRA debt currently stands at £140.6m.

10.3 Currently, two separate pools are operating for the management of HRA and GF debt. The advantage of this is that the HRA and GF borrowing strategies can be targeted to meeting their separate business demands.

10.4 Under the two pool approach legacy loans were notionally apportioned between the HRA and general fund using the CFR split and future loans will be raised separately.

10.5 An equitable means of apportioning debt management expenses is in operation.

10.6 The council now operates a targeted treasury management strategy for the HRA and GF, e.g. rescheduling of debt can take place for one pool or the other or even across pools, to the extent that loans can be split.

10.7 HRA borrowing is capped by the government and the HRA therefore needs to borrow within the parameters of its existing debt and the cap known as the headroom. The HRA have agreed with the Secretary of State an addition to the headroom of £15.2m from 2017/18.

11. Annual Investment Strategy

11.1 The annual investment strategy is set out in Annex 5 for approval by Council. This covers:

- Overview including durations bans for counterparties and minimum credit ratings (tables 1 and 2 of Annex 5)
- Policy lending – non treasury management investments
- Investment balances / liquidity of investments
- Specified / unspecified investments

12. Financial Implications

12.1 Investment income is currently forecast to be £1.2m for 2016/17 nearly in line with the budgeted estimate. For 2017/18 budgeted investment income is estimated at approximately £1.6m to reflect slightly higher interest returns being achieved.

12.2 Savings on borrowings have accrued because only a small proportion of the borrowing scheduled to be made in 2016/17 was actually raised.

12.3 Minimum Revenue Provision (MRP) which is the charge to revenue to ensure that debt used to finance expenditure is paid over a period that reflects useful life of the capital expenditure came in on budget.

12.4 The principle that any savings arising from the treasury budget can be deployed to direct revenue financing of capital expenditure has been agreed by members. This opportunity of additional support for capital saves the council revenue costs on borrowing. Every £1m deployed in this way saves some £0.100m per year in capital financing costs. Hence, any savings generated from the treasury operations can be directed to fund the capital programme.

13. Balanced Budget Requirement

13.1 The council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

13.2 Risk management plays a fundamental role in treasury activities due to the value and nature of transactions involved. In order to mitigate risks on investment income the council holds a business risk reserve, which can be used to manage unforeseen volatility of investment income or borrowing costs.

13.3 Budgeting for MRP under the new guidance method requires the council to make provision for MRP linked to the life of the assets being enhanced. This has made budgeting for MRP more complex and sensitive to changes in assets being financed and the amount on unsupported borrowing used.

Annex 1 – TM Policy Statement

TREASURY MANAGEMENT POLICY STATEMENT

The London Borough of Ealing defines the policies and objectives of its treasury management activities as follows: -

(i) This organisation defines its treasury management activities as:
"The management of the authority's 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".

(ii) This organisation 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.

(iii) This organisation acknowledges 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 best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

Annex 2 – TM Scheme of Delegation

TREASURY MANAGEMENT SCHEME OF DELEGATION

Ealing's Treasury Management Scheme of Delegation is approved by Full Council annually as part of the overall Treasury Management Strategy, it was last approved by Council at its meeting of 23 February 2016 and there are no proposals for any amendments to the current scheme, which is set out below:

(i) Council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement
- approval of annual strategy.

(ii) Section 151 Officer/ Director of Finance

- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Annex 2 – TM Scheme of Delegation

The treasury management role of the section 151 officer

The S151 (responsible) officer/ Director of Finance

- recommending clauses, treasury management policy for approval, reviewing the same regularly, and monitoring compliance
- formulating consulting on and approving the treasury management practices, outlining the detailed manner in which the treasury management function will operate
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

Policy on the use of external service providers

The council uses Capita Asset Services as its external treasury management advisers. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

Capita are the council's current treasury management advisers.

Annex 3 – Prudential Indicators

Prudential Indicators

1 Capital Prudential Indicators

1.1 The council's capital expenditure plans are a key driver of treasury management activity.

Capital Expenditure

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

Table 1: Capital Expenditure Forecast

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Non-HRA	119.045	146.450	59.004	28.763	7.168
HRA	72.058	128.913	74.027	70.639	55.139
Total	**191.103**	**275.363**	**133.031**	**99.402**	**62.307**

1.3 Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which are classified as borrowing instruments.

1.4 Table 2 outlines how the capital expenditure plans are proposed to be financed by capital or revenue resources. Any shortfall of resources results in a funding need i.e. borrowing.

Annex 3 – Prudential Indicators

Table 2: Capital Programme Funding Summary

Capital Expenditure	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Non-HRA	119.045	146.450	59.004	28.763	7.168
HRA	72.058	128.913	74.027	70.639	55.139
Total	**191.103**	**275.363**	**133.031**	**99.402**	**62.307**
Financed by:					
Capital receipts	13.000	6.368	8.651	-	-
Capital grants	50.378	58.674	24.699	13.069	4.743
Revenue Contribution	3.309	2.269	1.200	0.825	-
Other: Parking Reserve; Invest to Save; Partnership; S106	10.411	11.312	0.457	0.050	-
Finance Lease Liability	-	-	-	-	-
PFI	-	-	-	-	-
Total Financed	**77.098**	**78.623**	**35.007**	**13.944**	**4.743**
HRA Direct funding	**40.181**	**117.989**	**56.482**	**68.745**	**54.144**
Net Financing Need (General Fund & HRA - Borrowing)	**73.824**	**78.751**	**41.542**	**16.713**	**3.420**
TOTAL FUNDING	**191.103**	**275.363**	**133.031**	**99.402**	**62.307**

New borrowing made up as follows:

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
New Year Borrowing HRA	31.877	10.924	17.545	1.894	0.995
New Year Borrowing GF	41.947	67.827	23.997	14.819	2.425
Total borrowing	**73.824**	**78.751**	**41.542**	**16.713**	**3.420**

Annex 3 – Prudential Indicators

The Council's Borrowing Need (the Capital Financing Requirement)

1.5 This prudential indicator is the council's capital financing requirement (CFR), which is simply the total historic unfinanced capital expenditure i.e. a measure of the council's underlying borrowing need. Any capital expenditure not immediately paid for, will increase the CFR. The requirement to set aside the minimum revenue provision (MRP) reduces the council's underlying need to borrow and the ensuing CFR.

1.6 The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council currently has £125.319m of such schemes that forms part of the CFR.

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

Table 3: CFR Projections - Capital Financing Requirement

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
CFR – non housing	478.666	533.260	541.875	540.558	526.356
CFR – housing	172.466	180.027	193.811	193.726	191.258
Total CFR ex OLTL	**651.132**	**713.287**	**735.686**	**734.284**	**717.614**
OLTL	125.319	120.143	115.186	110.505	105.462
Total CFR inc. OLTR	**776.451**	**833.430**	**850.872**	**844.789**	**823.076**

Movement in CFR ex OLTL represented by:

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Net financing need for the year	73.824	78.751	41.542	16.713	3.420
Less MRP/VRP* and other financing movements	(16.565)	(13.233)	(15.383)	(16.136)	(16.627)
Movement in CFR	**57.259**	**65.518**	**26.159**	**0.577**	**(13.207)**

Annex 3 – Prudential Indicators

1.8 Under the capital finance regulations, local authorities are permitted to borrow up to three years in advance of need. This council will only consider borrowing in advance of need if market conditions indicate that it is the best course of action. One of the reasons for borrowing in advance is to take advantage of and lock in low long term interest rates, especially if officers are of the opinion that long term rates are likely to rise. There is a short term carry cost to borrowing in advance of need as currently investment rates are considerably lower than long term borrowing rates. Borrowing in advance of need also increases the level of temporary investments and thus increases the exposure to loss of investment principal. However, the council has put in place a prudent methodology to minimise this risk.

Annex 3 – Prudential Indicators

2 Affordability Prudential Indicators

2.1 **Actual and estimates of the ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 4: Ratio of financing costs to revenue streams

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	%	%	%	%	%
Non-HRA	8.58	14.07	15.21	15.05	15.35
HRA (inclusive of settlement)	10.55	13.15	14.08	13.81	13.98

2.2 The estimates of financing costs include current commitments and the proposals in this budget report.

Estimates of the incremental impact of capital investment decisions on council tax

2.3 This indicator identifies the revenue costs associated with proposed changes to the capital programme recommended in this budget report compared to the council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support, which are not published over a three year period.

Table 5: Incremental impact of capital investment decisions on the band D council tax

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£	£	£	£	£
Council tax - Band D	**12.38**	**26.20**	**4.09**	**-**	**-**

HRA ratios – Incremental Impact of Capital Investment Decisions on Housing Rent (Unsupported Borrowing)

Annex 3 – Prudential Indicators

2.4 Similar to council tax calculation, this indicator outlines the impact of proposed changes in the housing capital programme on weekly rent levels.

Table 6: HRA Ratios

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estima te	2019/20 Estimate	2020/21 Estimate
	£	£	£	£	£
Average Weekly Increase/(Decrease) in Housing Rents	**2.78**	**0.86**	**1.42**	**0.16**	**0.08**

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
HRA debt (£m)	172.466	180.027	193.811	193.726	191.258
HRA revenues (£m)	68.551	67.250	66.215	65.273	63.605
Ratio of debt to revenues %	39.75%	37.36%	34.16%	33.69%	33.26%

	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
HRA Debt (£m)	172.466	180.027	193.811	193.726	191.258
Number of HRA Dwellings	11,877	11,616	11,386	11,198	10,796
Debt per dwelling (£m)	0.015	0.015	0.017	0.017	0.018

Annex 3 – Prudential Indicators

3 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

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

Table 7 – Treasury Indicators Limits on borrowing activity

Operational Boundary – General Fund & HRA	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Debt	713.287	735.686	735.686	734.285	717.614
Other long term liabilities	125.319	120.143	115.186	110.505	105.462
Total	**838.606**	**855.829**	**850.872**	**844.790**	**823.076**

The Authorised Limit for external debt

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

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

3.4 The council is asked to approve the following Authorised Limit:

Annex 3 – Prudential Indicators

Table 8 – Authorised Limits

Authorised limit - General Fund & HRA	2016/17 Projected Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Debt	743.287	765.686	765.686	764.285	747.614
Other long term liabilities	125.319	120.143	115.186	110.505	105.462
Total	**868.606**	**885.829**	**880.872**	**874.790**	**853.076**

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

Table 9 – HRA Debt limit

HRA Debt Limit	**2016/17 Projected Outturn**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
	£m	£m	£m	£m	£m
HRA debt cap	199.759	205.076	213.116	215.010	215.010
HRA CFR	172.466	180.027	193.811	193.726	191.258
HRA headroom	**27.293**	**25.049**	**19.305**	**21.284**	**23.752**

Annex 3 – Prudential Indicators

Table 10 – Treasury Indicators and limits

	2016/17	2017/18	2018/19
Interest rate Exposures			
	Upper %	**Upper %**	**Upper %**
Limits on fixed interest rates based on net debt	100	100	100
Limits on variable interest rates based on net debt	50	50	50
Limits on fixed interest rates:			
• Debt only	100	100	100
• Investments only	100	100	100
Limits on variable interest rates			
• Debt only	50	50	50
• Investments only	100	100	100

Maturity Structure of fixed interest rate borrowing 2017/18		
	Lower %	**Upper %**
Under 12 months	-	10
12 months to 2 years	-	20
2 years to 5 years	-	20
5 years to 10 years	-	20
10 years and above	30	90

Maturity Structure of variable interest rate borrowing 2017/18		
	Lower %	**Upper %**
Under 12 months	-	100
12 months to 2 years	-	100
2 years to 5 years	-	100
5 years to 10 years	-	100
10 years and above	-	100

Annex 4 – MRP Policy Statement

1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 require the Council to determine for the current financial year an amount of minimum revenue provision which it considers to be prudent. This involves allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure provides benefit.

2 Current Positon

2.1 On 23 February 2016, within the Budget Strategy Report 16 – 17 contained within Annex 4 of Appendix 10 (Treasury Management Strategy Statement 2016-17) the Council confirmed the existing Minimum Revenue Provision Policy as follows:

3 Minimum Revenue Provision (MRP) Policy Statement

3.1 For capital expenditure incurred before 1 April 2008 or which in the future will be supported capital expenditure, the MRP policy will continue to be:

3.1.1 **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1); this option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

4 (ii) For expenditure incurred from 1 April 2008, the MRP policy will continue to be based on the estimated life of the assets (Option 3). An in depth review of the applicable options for MRP charges was carried out in 2008 when the regulations were introduced effective from 2009/10.

5 It was agreed at the Cabinet meeting of 24 February 2009 and Council meeting of 03 March 2009 that, the council makes MRP charges to revenue in accordance with option 3, the asset life method as opposed to option 4 depreciation, which would have required the additional resource and administrative expense of tracking and revaluing assets at regular intervals. There is no basis for a change in policy and in accordance with approval sought and received in 2009 the council will continue to apply option 3.

5.1.1 **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a capitalisation direction) (option 3); this option provides for a reduction in the borrowing need over approximately the asset's life.

6 Under this Policy the total charge to the General Fund budget in 2016-17, excluding PFI and finance leases is expected to be approximately **£16.5m** of which a significant element **(£9.053m)** is in relation to debt incurred prior to 1 April 2008 calculated in accordance with the 'Existing Practice' point in above paragraph i.e. employing the 4% reducing balance method.

7 Revised Strategy

7.1 Officers keep under constant review all treasury management practices to ensure they offer the most appropriate solution for the Council and ensure prudent provision is being made in relation to its capital activity. In relation to the debt incurred prior to 1 April 2008, officers have identified an opportunity to make the Council's provision more prudent. A supplementary benefit is that a revised policy will also make capacity in the General Fund in 2017/18 of approximately **£4.3m** and with substantial but reducing capacity for the following **17** years.

Annex 4 – MRP Policy Statement

8 The Council will have outstanding debt on expenditure incurred prior to 1 April 2008 of **£217.2m on 1/4/2017** hence, based on current policy i.e. 4% per year on a reducing balance, the charge in 2017-18 is **£8.69m.** The outstanding debt gradually reduces over time but the methodology is such that it will never be fully provided for.

9 Whilst the current policy is one of the options set out in Government guidance, the guidance makes clear that it is not mandatory for local authorities to follow one of its suggested options. It is for the Council to determine its own methodology as long as it is prudent for local circumstances.

10 Whilst it has never been possible to allocate the Council's outstanding debt to specific assets it is likely that most of the pre-1 April 2008 debt has arisen from expenditure on land and buildings most of which, even today, are likely to have an outstanding life of at least 50 years.

11 Officers have reviewed the methodology and concluded that charging for the pre-1 April 2008 debt by the use of 2% straight line method, whereby the debt would be divided into 50 with an equal charge made in each year over the next 50 years, would be more prudent. It would ensure that the whole debt was covered within a reasonable timescale. The exact profile of provision under the current and proposed methodologies is shown below.

12 It is therefore recommended that in respect of capital expenditure incurred before 1 April 2008, Cabinet recommends to the Council that the Minimum Revenue Provision Policy be revised to read:

13 *"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 2017 for the subsequent* 50 years"

14 Annexes to include analysis of current practice vs proposed estimated opening (General Fund) Capital Financing Requirement of **£478.6** of which **£217.2m** relates to pre 2008 borrowing requirement: -

Annex 4 – MRP Policy Statement

	Option 1 (existing) Provision £	Proposed Provision £	Annual Charge Reductions/ (Increases) £
Opening CFR	217,295,412	217,295,412	
Year 1	8,691,816	4,345,908	4,345,908
Year 2	8,344,144	4,345,908	3,998,236
Year 3	8,010,378	4,345,908	3,664,470
Year 4	7,689,963	4,345,908	3,344,055
Year 5	7,382,364	4,345,908	3,036,456
Year 6	7,087,070	4,345,908	2,741,162
Year 7	6,803,587	4,345,908	2,457,679
Year 8	6,531,444	4,345,908	2,185,536
Year 9	6,270,186	4,345,908	1,924,278
Year 10	6,019,378	4,345,908	1,673,470
Year 11	5,778,603	4,345,908	1,432,695
Year 12	5,547,459	4,345,908	1,201,551
Year 13	5,325,561	4,345,908	979,653
Year 14	5,112,538	4,345,908	766,630
Year 15	4,908,037	4,345,908	562,129
Year 16	4,711,715	4,345,908	365,807
Year 17	4,523,247	4,345,908	177,339
Year 18	4,342,317	4,345,908	(3,591)
Year 19	4,168,624	4,345,908	(177,284)
Year 20	4,001,879	4,345,908	(344,029)
Year 21	3,841,804	4,345,908	(504,104)
Year 22	3,688,132	4,345,908	(657,776)
Year 23	3,540,607	4,345,908	(805,301)
Year 24	3,398,982	4,345,908	(946,926)
Year 25	3,263,023	4,345,908	(1,082,885)
Year 26	3,132,502	4,345,908	(1,213,406)
Year 27	3,007,202	4,345,908	(1,338,706)
Year 28	2,886,914	4,345,908	(1,458,994)
Year 29	2,771,437	4,345,908	(1,574,471)
Year 30	2,660,580	4,345,908	(1,685,328)
Year 31	2,554,157	4,345,908	(1,791,751)
Year 32	2,451,990	4,345,908	(1,893,918)
Year 33	2,353,911	4,345,908	(1,991,997)
Year 34	2,259,754	4,345,908	(2,086,154)
Year 35	2,169,364	4,345,908	(2,176,544)
Year 36	2,082,590	4,345,908	(2,263,318)

Annex 4 – MRP Policy Statement

	Option 1 (existing) Provision £	Proposed Provision £	Annual Charge Reductions/ (Increases) £
Year 37	1,999,286	4,345,908	(2,346,622)
Year 38	1,919,315	4,345,908	(2,426,593)
Year 39	1,842,542	4,345,908	(2,503,366)
Year 40	1,768,840	4,345,908	(2,577,068)
Year 41	1,698,087	4,345,908	(2,647,821)
Year 42	1,630,163	4,345,908	(2,715,745)
Year 43	1,564,957	4,345,908	(2,780,951)
Year 44	1,502,358	4,345,908	(2,843,550)
Year 45	1,442,264	4,345,908	(2,903,644)
Year 46	1,384,574	4,345,908	(2,961,334)
Year 47	1,329,191	4,345,908	(3,016,717)
Year 48	1,276,023	4,345,908	(3,069,885)
Year 49	1,224,982	4,345,908	(3,120,926)
Year 50	1,175,983	4,345,908	(3,169,925)

Annex 5 – Annual Investment Strategy

ANNUAL INVESTMENT STRATEGY

1. OVERVIEW

1.1 The council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The council's investment priorities remain: -

- security of the invested capital;
- liquidity of the invested capital; and
- an optimum yield which is commensurate with security and liquidity.
- All investments will be in sterling.

Changes to Credit Rating

1.2 The main credit agencies provided credit rating uplifts to finacial institutions based on the implied levels of sovereign support. However due to regulatory changes which are being phased in their methodologies have changed, with a focus away from implied support towards factors such as regulatory capital levels. In netting off the removal of support ratings and taking other factors into consideration underlying ratings have either remained unchanged or changed slightly. As no attention is being paid to support ratings where they still exist. Hence attention is paid to just short and long term ratings.

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

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the council to determine the suggested duration for investments that exist on Capita's recommended counterparty list. The council will therefore use counterparties within the following durational (colour) bands

Annex 5 – Annual Investment Strategy

Colour	Suggested Duration
Yellow	5 years *
Dark Pink	5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
Light Pink	5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No Colour	Not to be used

Table 1 – Durational bands for Counterparties

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	**Amount and/or % Limit per institution £m**	**TRIB Local current limit per institution £m**
UK Government Debt or Equivalent *	**Yellow**	**Unlimited**	**40**
Banks	**Purple (2 years)**	**50**	**-**
Banks	**Orange (1 year)**	**50**	**30**
Banks – part nationalised	**Blue (1 year)**	**50**	**40**
Banks	**Red (6 months)**	**40**	**30**
Specific Overnight Limit with Council's Own Banker - £20m			
Banks	**Green (100 days)**	**30**	**20**
Banks	**No colour**	**Not to be used**	**-**
Limit 3 category – Council's banker (not meeting Banks 1)	**blue**	**50**	**-**
Policy Investment lending limit	**-**	**To be determined on a case by case basis**	**-**
DMADF	**AAA**	**Unlimited**	**120**
Local authorities	**n/a**	**15**	**10**
Money market funds	**AAA**	**15**	**-**

Annex 5 – Annual Investment Strategy

Note: The Treasury Risk and Investment Board (TRIB) under the auspices of the Executive Director of Corporate Resources and the Director of Finance have delegated powers to make changes to their local operational limits, but remain within the parameters of the Treasury Strategy.

1.4 The council is alerted of changes to ratings and of all three agencies through its use of its adviser's creditworthiness service. In addition to the use of credit ratings the council will be advised of information on movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the council's lending list

1.5 If a downgrade results in the counterparty/investment scheme no longer meeting the council's minimum criteria, its further use as a new investment will be withdrawn immediately except in the circumstances out lined above where TRIB determines the counterparty can remain on the councils list.

1.6 Sole reliance will not be placed on the use of this external service. In addition this council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.

Country limits

1.7 The changing regulatory environment in conjunction with rating agencies' new methodologies also means that sovereign ratings are not of lesser importance in the assessment process. The new regulatory environment is therefore attempting to break the link between sovereign support and domestic financial institutions.

1.8 Although this authority understands the changes that have taken place the council has still determined that it will only use approved counterparties from countries with a minimum sovereign credit rating from Fitch of AA- (or equivalent from other agencies if Fitch does not provide a rating). However, it must be noted that the most likely position is that any foreign institution the council invest in should be as highly rated as the UK or better. Investments in the UK will not be subject to sovereign credit worthiness rating restriction.

1.9 The list of countries which currently meet this criterion are outlined in Annex 5 as part of the treasury strategy. The Director of Finance will monitor and update the position under delegated powers and report back to Council at the earliest opportunity.

1.10 Where Institutions are not on the council's advisers list and the council makes its own assessment, the council will only lend to counterparties using the minimum criteria specified below.

Annex 5 – Annual Investment Strategy

1.11 The minimum credit rating required for an institution to be included in the council's counterparty list (where Capita credit worthiness service is not being used) is as follows:

Table 2 – Minimum credit ratings

	Long-Term	Short-Term
Fitch	A	F1
Moody's	Baa1	P-2
Standard & Poors	A-	A-2

Sovereign Rating	Same rating as the UK or higher
Money Market Funds	AAA

Note: The above does not apply to policy investments.

1.12 As outlined above officers also take any market intelligence gleaned into consideration to further determine whether to suspend institutions from the list even though the institution meets our minimum lending criteria.

1.13 Setting and monitoring of the counterparty list and the agreed maximum limit per counterparty (and council's rating criteria) constitutes part of the execution and administration function and forms part of the authority to "determine the annual treasury strategy and carry out all treasury management activities" as per the council's scheme of delegation outlined in our financial regulations. The Director of Finance therefore has discretion to review and amend these minimum ratings in view of market conditions and report to Council at the earliest opportunity.

1.14 Officers have to respond quickly to counterparty rating changes and include or suspend institutions as their ratings fall in/out of the council's minimum rating criteria. This ensures that investment risk continues to be spread across a range of credit worthy institutions. The lending list is under ongoing review by the Director of Finance under delegated authority.

1.15 Institutions with which the council currently place funds are as follows:

- Bank of England Debt Management Office (DMO). The rates of interest from the DMO are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the council's capital is secure particularly in times of high market volatility.
- The British institutions where the UK has a substantial stake such as Lloyds and RBS
- Other UK institutions meeting our minimum credit rating criteria
- AAA rated money market funds.
- Other local authorities (LAs) are relatively risk free counterparties. In the CLG's own investment guidance issued to councils, LA deposits are deemed to offer high security and liquidity. Their limit is set at £5m for district councils and £10m for other LAs, subject to a group limit of £180m.

Annex 5 – Annual Investment Strategy

- Foreign institutions from countries with sovereign ratings equivalent to the UK's sovereign rating or higher provided they meet our minimum criteria.
- Institutions that fall within Capita (our treasury management consultants) approved lending list having met the diverse criteria and who the council assess as having sound credit worthiness.
- UK government – (gilts and treasury bills).

2. POLICY LENDING– NON TREASURY MANAGEMENT INVESTMENTS:

2.1 In some circumstances the council may have entered into a partnership arrangement with organisations or institutions for the provision of a service/facility that will directly promote the council's policy objectives which either requires the council to lend or jointly invest in a venture. Or the council may invest in a venture that furthers one or more of the council's policy objectives.

2.2 These types of policy investments do not form part of the treasury management strategy as such and are therefore not required to be included in the treasury management strategy statement.

2.3 This council has already entered into some lending activities in support of the policy objectives of the council. Three policy related investments have been made, including a loan of £0.6m to a PFI partner Future Ealing and the other being a loan of £15m to West London Waste Authority.

Table 3 – Policy investments entered into by Ealing Council

Organisation	£m	Description
Future Ealing	0.60	This is an investment that LBE made, which was part of a PFI structure
West London Waste Authority (WLWA)	15.00	An Invest to Save loan granted to West London Waste Authority (WLWA) towards the project for the development of a new Energy from waste facility. Interest payments for this loan commenced January 2017.
Ealing Community Resource Centre Ltd (ECRC)	0.05	This was a loan granted to ECRC in February 2014 for financial support towards the running costs of the Lido Centre in West Ealing

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3. INVESTMENT BALANCES / LIQUIDITY OF INVESTMENTS

3.1 Based on Ealing's cash flow forecasts, the council anticipates its fund balances in 2017/18 to average around £160m if no long term borrowing is raised and we persist with the internal borrowing policy to fund the Council's underlying need to borrow. Balances will be higher if we raise external borrowing. For treasury investments, it is considered that the maximum percentage of its overall investments that the council should hold for more than 365 days is £20m. (Investments with a maturity exceeding a year). The prudential indicator figure of £20m for 2017/18 is therefore recommended. It should be noted that this indicator does not apply to investments made for policy reasons.

3.2 In addition, the council may enter into forward deals, but with an exposure that does not exceed 5 years, from the date the forward deal was effected

3.3 The actual amount available for investment in 2017/18 will fluctuate as a result of the timing of significant items such as:

- expenditure on capital projects
- council tax, business rates, council house rents income
- receipt of government grants
- long-term loans taken out to fund capital expenditure
- capital receipts in respect of major asset sales

3.4 The amounts available for investments consist of both cash flow and core balances made up of reserves not likely to be required for one to two years. It is possible for the council to invest this core cash for longer term. The strategy is flexible and allows the Director of Finance to take the decision to extend the duration of lending when market conditions are conducive to such lending.

Investment Strategy and Interest Rate Outlook

3.5 The council avoids locking into longer term deals while investment rates are down at historical low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the council.

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

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

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3.7 The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in bank rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

3.8 The projected investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%

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

4. SPECIFIED/ UNSPECIFIED INVESTMENTS

4.1 **SPECIFIED INVESTMENTS**: All such investments will be sterling denominated, with **maturities up to maximum of 2 years**, meeting the minimum 'high' quality criteria where applicable.

4.2 **NON-SPECIFIED INVESTMENTS**: These are any investments which do not meet the specified investment criteria. A maximum of 30% can be held in aggregate in non-specified investment.

4.3 A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

4.4 The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

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Table 4 – Parameters applying to institutions or investment vehicles

	Minimum credit criteria / colour band	**Max % of total investments or maximum amount of investment per institution**	**Max. maturity period**
DMADF – UK Government	N/A	**100%**	**6 months**
		£m	
UK Government gilts	UK sovereign rating	20	30 years
UK Government Treasury bills	UK sovereign rating	50	1 year
Bonds issued by multilateral development banks	UK sovereign rating	10	6 months
Money market funds	AAA	30	Liquid
Enhanced money market funds with a credit score of 1.25	AAA	5	Liquid
Enhanced money market funds with a credit score of 1.5	AAA	5	Liquid
Local authorities	N/A	15	24 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour	50	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	40	12 months 12 months 6 months 100 days Not for use
Corporate bond funds		10	N/A Tradable
Gilt funds	UK sovereign rating	20	N/A Tradable
Property funds		10	N/A Tradable

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4.5 **SPECIFIED INVESTMENTS:**

(All such investments will be sterling denominated, with **maturities up to maximum of 2 years**, meeting the minimum 'high' rating criteria where applicable)

Table 5 – Specified Investments

	Minimum Credit Criteria	Use	Max. maturity period
Debt Management Agency Deposit Facility	N/A	In- house	6 months
Term deposits – local authorities	N/A	In-house	2 year
Term deposits – banks and building societies	Green credit band per capita credit worthiness service	In-house	1 year

Table 6 – Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	Use	Max. maturity period
UK part nationalised banks	Green credit band per capita credit worthiness service	In-house	**1 year**
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Green credit band per capita credit worthiness service	In-house and Fund Managers	**1 year**

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Table 7 – Other Investments Specified Investments

	Minimum Credit Criteria	Use	Max. maturity period
Collateralised deposit	Green credit band per capita credit worthiness service	In-house	**1 year**
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	Green credit band per capita credit worthiness service	In-house and Fund Managers	**1 year**
UK Government Gilts	UK Government Rating	In-house buy and hold and Fund Managers	**1year**
Treasury Bills	UK sovereign rating	In house and Fund Managers	**1 year**
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or Green bank	In-house	**1 year**
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Managers	**1 year**
Bonds issued by multilateral development banks	Long Term AAA rating	In-house buy and hold and Fund Managers	**Liquid**
Government Liquidity Funds	UK Government liquidity funds only	In-house and Fund Managers	**Liquid**
Money Market Funds	Fitch – AAAmmf S&P – AAAm Moodys – AAAmf	In-house and Fund Managers	**Liquid**

Notes:

- *If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.*
- *Buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.*
- *As collateralised deposits are backed by collateral of AAA rated local authority LOBOs, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority.*

LOCAL AUTHORITIES

- *Although most local authorities do not have credit ratings, investing with local authorities provides good security for the council.*

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4.6 **Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this council. To ensure that the council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

4.7 **Blanket guarantees on all deposits.** Some countries may support their banking system by giving a blanket guarantee on all deposits, however; this council will generally not rely on the guarantees provided by any government unless there are overriding reasons for doing so.

4.8 **Other Countries.** At present the council will determine whether to include other countries by reference to credit rating of the sovereign together with financial news data on the sovereign. The minimum credit rating required for an institution to be included within the council's list is AA-, although the council more likely invest in sovereigns that have a rating equivalent to or better than the UK governments rating. Currently the countries falling within this are as follows:

Table 8 – Credit Rating of other countries

AAA	AA+	AA	AA-
Australia	Finland	Abu Dhabi (UAE)	Belgium
Canada	Hong Kong	France	-
Denmark	U.S.A	Qatar	-
Germany	-	U.K	-
Luxembourg	-	-	-
Netherlands	-	-	-
Norway Singapore Sweden Switzerland	-	-	-

Note: Although the Executive Director of Corporate Resources and the Director of Finance have discretion under this strategy to invest outside the UK, the current position is that investments are not currently being placed overseas. However, the position is kept under regular review.

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4.9 **Non Specified Investments**

Table 9 – Non Specified Investments

A. Maturities of any period.

Fixed term deposits with variable rate and variable maturities: -	Minimum Credit Criteria	Use
Callable deposits	Falling within the council's criteria	In-house
Range trade	Falling within the council's minimum criteria	In-house
Other debt issuance by UK banks covered by UK Government guarantee	UK Government explicit guarantee	In-house and Fund Managers
Term deposits with unrated counterparties	Decision flowing through TRIB, or a delegated officer	In-house
Commercial Paper	Fitch F1, AA aa1 or equivalent.	In-house / Fund Managers
Corporate Bonds	Fitch F1, AA aa1 or equivalent.	In-house/ Fund Managers
UK Floating Rate Notes	Fitch F1, AA aa1 or equivalent.	In-house/Fund Managers
VNAV MMF's (where there is greater than 12 month history of a consistent £1 Net Asset Value)	High Credit Score	In-house and Fund Managers
Bond Funds	Long term AAA	In-house and Fund Managers
Gilt Funds	Long Term AAA	In-house and Fund managers

B. Maturities in excess of 1 year

Investments as specified above in specified investments, but for periods in excess of 1 year.

Note: Where indicated, Capita credit worthiness bands will apply unless Ealing exercises its discretion to disregard some of the non-credit rating measures used by Capita Services. Certain market conditions can bring about inconsistent outcomes, and local discretion may be invoked.

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Investment Treasury Indicator and Limit

4.10 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 the council becoming a forced seller of an investment, and are based on the availability of funds after each year-end.

The council is asked to approve the treasury indicator and limit: -

Table 10 – Investment Treasury Indicator and limit to be approved

Maximum principal sums invested > 364 days			
	2016/17	2017/18	2018/19
	£m	£m	£m
Principal sums invested > 364 days	20	20	20

Note: This durational limit excludes policy investments, were the decision is made on a case by case basis.

4.11 For its cash flow generated balances, the council will seek to utilise money market funds, call accounts and short-dated deposits (overnight to three months), treasury bills and the debt management office.

Investment Risk Benchmarking

4.12 These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

Security

4.13 The council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **<1% historic risk of default when compared to the whole portfolio.**

Liquidity

4.14 In respect of liquidity the council seeks to maintain:

- Bank overdraft - £2m
- Liquid short term deposits of at least £5m available with a week's notice.

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Yield

4.15 Local measures of yield benchmarks are:
Investments – internal returns above the 7 day LIBID rate

In addition, the security benchmark for each individual year is:

Table 11 – Security Benchmark for each individual year

	1 year	2 years	3 years	4 years	5 years
Maximum %	2%	2%	2%	2%	2%

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

Provisions for Credit-related losses

4.16 If any of the council's investments appeared at risk of loss due to default (i.e. this is a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) then the council will make revenue provision of an appropriate amount.

End of year Investment Report

4.17 At the end of the financial year, the council will prepare a report on its investment activity as part of its annual treasury management report.