Reigate & Banstead
BOROUGH COUNCIL
Banstead I Horley I Redhill I Reigate

REPORT OF:	HEAD OF FINANCE
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TO:	OVERVIEW AND SCRUTINY COMMITTEE
DATE:	16 FEBRUARY 2017

WARD (S) AFFECTED:	ALL

SUBJECT:	**DRAFT TREASURY MANAGEMENT STRATEGY 2017/18**

RECOMMENDATIONS:

The Committee is requested to consider the draft Treasury Management Strategy published by the Executive on 26 January 2017 and to offer any comments to the Executive on this report.

SUMMARY:

This report provides the Committee with the report published by the Executive on the draft Treasury Management Strategy 2017/18 for consultation.

The Committee is requested to consider this report and to submit any comments to the Executive on the draft Strategy.

The Committee is also requested to consider the comments made at the Treasury Management Portfolio Holder Panel meeting held on 8 February 2017 which also considered the draft Strategy.

STATUTORY POWERS

1. The Local Government Act 2000 introduced the requirement for Overview and Scrutiny Committees. The Council's Constitution provides arrangements for the Committee to consider Policy Framework documents, which includes Treasury Management policy.

DRAFT TREASURY MANAGEMENT STRATEGY 2017/18

2. The Executive on 26 January 2017 published the attached draft Treasury Management Strategy 2017/18 for consultation.

3. The annexes break the Strategy down into three main sections:

   - the Investment Strategy;
   - the Borrowing Strategy; and
   - the Cash Management Strategy.

4. The only significant change proposed is to increase the borrowing limits. This is detailed in Annex 2 of the report (Borrowing Strategy)

5. The draft Strategy will be considered by the Treasury Management Portfolio Holder Panel on 8 February 2017. The comments and conclusions of that Panel will be reported to the Committee.

6. The Committee is requested to consider the draft Strategy and to provide comments to the Executive at their meeting on 23 March 2017.

Background Papers: Executive Agenda: 26 January 2017

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REPORT OF:	HEAD OF FINANCE (CFO)
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TO:	EXECUTIVE
DATE:	26 January 2017
EXECUTIVE MEMBER:	COUNCILLOR T SCHOFIELD

KEY DECISION REQUIRED:	YES
WARD(S) AFFECTED:	ALL

SUBJECT:	**DRAFT TREASURY MANAGEMENT STRATEGY 2017/18**

RECOMMENDATION:

The Executive approve the contents of this report and annexes for formal consultation in accordance with the Council's Constitution.

REASON FOR RECOMMENDATION:

To support the adoption of a Treasury Management Strategy for the 2017/18 financial period.

EXECUTIVE SUMMARY:

To comply with the Code of Practice on Treasury Management the Council has to annually approve prudential indicators and a Treasury Management Strategy that reflects the Council's expected operations in this area for the 2017/18 financial year.

The above recommendation can be determined by the Executive.

STATUTORY POWERS

1. The Council operates its Treasury Management activity as an integral part of its statutory obligation to effectively manage the Council's finances under the *Local Government Act 2003* and associated regulations.
2. The Council's Treasury Management activities are undertaken in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the Prudential Code for Capital Finance in Local Authorities, and the Government's Investment Regulations.

ISSUES

3. The Council is required to approve an annual Treasury Management Strategy and Prudential Indicators so that borrowing and investments are prudent, affordable and sustainable.

4. The Strategy consists of three separate statements that have been compiled in accordance with the Council's Treasury Management Policy Statement.

5. These are:

   - The Investment Strategy (**Annex 1**)
   - The Borrowing Strategy (**Annex 2**)
   - The Cash Management Strategy (**Annex 3**)

6. Each document contains the appropriate Prudential Indicators relevant to that area. In addition, the Treasury Risk Management Assessment has been incorporated in the report as **Annex 4**.

Objectives

7. To accord with the Council's Treasury Management Policy Statement, the Treasury Management Strategy has the following objectives:

   - To consider and effectively address the risks associated with Treasury Management activity.
   - To optimise the flow of cash through the organisation in order to maximise the potential for using it to earn investment income for the Council.
   - To optimise the returns from investments whilst meeting the overriding need to protect the capital sum and ensure that the cash is available when the Council requires it.
   - To align investments in relation to cash flow, within statutory constraints, in order to increase investment returns in future years.
   - To optimise the revenue costs of undertaking all treasury activities.
   - To monitor and review significant changes in the pattern of cash movements and interest rate movements and react accordingly.

The Treasury Position 2016/17

8. The following table shows the Council's net investment position at 30 November 2016 and the projected position for 31 March 2017. The table also splits both the borrowings and investments between fixed or variable interest rates.

Table 1: Treasury Position 2016/17

	Actual as at 31/03/16 £'000	Average Earnings or Interest Paid Rate %	Current Position as at 31/12/16 £'000	Estimated Position as at 31/03/17[1] £'000	Anticipated Average Earnings or Interest Paid Rate %
Fixed Rate Borrowings	0	n/a	0	0	n/a
Variable Rate Borrowings	0	n/a	0	0	n/a
TOTAL BORROWINGS	0	0.00%	0	0.00	0.00%
Fixed Investments:					
Externally managed	43,000	0.92%	43,000	43,000	1.03%
In house	5,000	1.05%	5,000	5,000	1.05%
Variable Investments	0	n/a	0	0	n/a
TOTAL INVESTMENTS	48,000	0.93%	48,000	48,000	1.03%
Net Investments	**48,000**		**48,000**	**48,000**	

9. The current economic environment continues to remain challenging for the Council with interest rates on short term investments remaining low. Returns for medium to long-term investments have however, shown improvement over the past financial year and we have improved returns marginally by increasing investment durations in a few cases.

Matters for consideration

10. Counterparty security remains the Council's over-arching investment objective and the criterion for selection of these institutions is not proposed to be changed. The change in strategy last year to incorporate some medium term investments has resulted in improved returns.

11. Due to the ongoing low interest rates relating to cash investments the Property team have been looking at possible acquisitions of investment properties, both inside and outside the borough. This will provide additional income to support the Council's budget in the current challenging financial environment. Each property investment will be considered individually and assessed before a decision is made.

12. The Authorised and Operational Limits for prudential borrowing require changing as our borrowing requirement has changed. Currently the authorised limit is £35m and the operational limit is £25m. It is proposed to increase these to £80m and £70m respectively. Full details are shown in **Annex 2** (Borrowing Strategy).

13. Minor wording changes are proposed to clarify the MRP policy in relation to loans to Council owned or controlled organisations.

14. Prudential Indicators

15. The statutory Prudential Indicators contained within the Treasury Management Strategy are considered a sound basis for the future and authority is sought to adopt them. A summary of the key indicators that impact upon the Council are set out in the following table. All of the prudential indicators are set out and explained in the Investment and Borrowing Strategies.

Table 2: Summary of 'Key' Prudential Indicators

	2016/17 Projected £'000	2017/18 Budget £'000	2018/19 Forecast £'000	2019/20 Forecast £'000	2020/21 Forecast £'000
Capital Expenditure	24,749.8	46,759.0	42,917.0	2,182.0	2,906.0
Capital Financing Requirement	0	0	0	0	0
Authorised Limit for External Debt	35,000	80,000	80,000	80,000	80,000
Operational Boundary for External Debt	25,000	70,000	70,000	70,000	70,000
Upper limits on variable rate exposure	25%	25%	25%	25%	25%
Upper limits on fixed rate exposure	100%	100%	100%	100%	100%

OPTIONS

16. There are 3 options:

17. Option 1 - To not support the contents of this report

This would leave the Council not being compliant with the Code of Practice, which will result in criticism from our External Auditor, KPMG.

It would also means that Officers will not have a mandate under which to undertake treasury management activities, which will lead to the Council only receiving minimal returns on its investments.

18. Option 2 - To defer the report and ask Officers to provide more information and/or clarification on any specific points

The current Investment Regulations issued by the Department of Communities and Local Government means that this strategy should be approved prior to the financial year to which it relates.

Any delay in approving the Strategy could leave the Council open to the same risks identified in option 1 above.

19. Option 3 – Approve the recommendations within this report

This would provide the best opportunity to minimise the risk of audit criticism and to maximise the potential returns that can be earned during the coming financial year.

This is the recommended option.

LEGAL IMPLICATIONS

20. There are no direct legal implications arsing from this report.

FINANCIAL IMPLICATIONS

21. The financial impacts of this proposed strategy have already been reflected within the Council's 2016/17 Budget proposals. There are no additional direct financial implications that arise from this report.

EQUALITIES IMPLICATIONS

22. There are no equality issues that need to be considered as part of this report.

RISK MANAGEMENT CONSIDERATION

23. These are detailed in **Annex 4** (Risk Management Assessment).

OTHER IMPLICATIONS

24. There are no other implications arising from this report.

CONSULTATION

25. This report will be reviewed by a Member Panel led by the Portfolio Holder for Planning Policy and Finance in early February and then by the Overview and Scrutiny Committee on 16 February.
26. It will then return to the Executive in its final form for consideration on 23 March, prior to its adoption by Council on 13 April.

POLICY FRAMEWORK

27. The Strategy is part of the Council's Policy Framework as set out in Article 4 of the Constitution.

Background Papers: Treasury Management Strategy 2016/17 (Report to Executive March 2016).

ANNEX 1

REIGATE & BANSTEAD BOROUGH COUNCIL

INVESTMENT STRATEGY

2017 / 2018

BACKGROUND

1. This strategy is made in accordance with the DCLG Guidance on Local Government Investments and the CIPFA Treasury Management Code of Practice.

2. This strategy applies to both in-house and externally managed funds. The external managers must confirm with the Council the acceptability of counterparty before an investment is made.

INVESTMENT OBJECTIVES

3. The Council's investment strategy primary objections are as follows:
   - Security – safeguarding the repayment of the principal sum invested
   - Liquidity – funds are available when needed
   - Yield – return on the investment (but only considered once the first two objectives are satisfied)

PRUDENTIAL INDICATORS

4. There are three indicators that apply to investments. The purpose of these indicators is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates impacting negatively upon the Council's overall financial position. However, if these are set up to be too restrictive they will impair the opportunities to optimise returns. The indicators are:

   a. Upper limits on variable interest rate exposure (see Table 1 below) – this identifies a maximum limit for variable interest rates based upon the debt position net of investments. This relates to deposits in structured or stepped arrangements.
   b. Upper limits on fixed interest rate exposure (see Table 1 below) - this relates to deposits in fixed-term arrangements.
   c. 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.

Table 1: Limits on variable and fixed interest rate exposure

Indicator	**2016/17**	**2017/18**	**2018/19**
Upper limits on variable rate exposure	25%	25%	25%
Upper limits on fixed rate exposure	100%	100%	100%

5. For liquidity planning processes the Council aligns the duration of its investments with the Council's anticipated spending requirements, up to a maximum of five years. This therefore sets the percentage of the investment portfolio that will be invested for more than 364 days.

6. The following table compare the Council's current overall cash flow requirement, which is its capital expenditure programme. This sets out the percentages that are then used to set the financial limits for investments in each time period. This sets the maximum limit as to how much can be invested for a period greater than 364 days.

Table 2: Analysis of investments

		<1 year	1-2 years	2-3 years	3-4 years	4-5 years	Total
Planned Expenditure programme	£000	24,297	6,759	2,917	2,182	2,906	46,427
	%	62%	17%	7%	6%	7%	100%
Potential Investment programme	£000	29,857	8,306	3,585	2,681	3,574	48,000
	%	62%	17%	7%	6%	7%	100%
Forecast Investment Position as at 31/12/2016	£000	43,000	0	5,000	0	0	48,000
	%	90%	0	10%	0	0	100%

OTHER PERFORMANACE INDICATORS

7. The Code of Practice on Treasury Management requires the Council to set Performance Indicators to assess the adequacy of the treasury function over the year. The Performance Indicators relevant to this Investment Strategy are set out in the following paragraphs.

(i) Internally managed funds

8. The in-house officer will focus their time on the overall management of the Council's cash flow and will limit their investments deals to durations that are under 3 years.

9. As the nature of these investments will be associated with the effective management of the cash flow, any investment opportunities will needs to be evaluated against the alternative cost of maintaining any short term borrowings that the Council may need.

(ii) Externally managed funds

10. The External Fund Managers will manage investment deals over the full range of durations from three months up to a maximum of 5 years (although limited by operational arrangements to a maximum of 3 years – see main report).

11. The performance of the External Manager is reviewed monthly. Officers and the Managers meet on an annual basis for a formal review of performance
.

12. Overall treasury management performance is reviewed monthly and reported biannually in the Mid-Year Treasury Performance and Treasury Management

Outturn reports.

RISK MANAGEMENT

13. In terms of implementing the above investment objective the Council will need to consider it against the risk elements identified in Treasury Management Risk Assessment Statement.

14. This risk assessment - showing how the risks will be managed in order to achieve the investment objectives - is set out on Appendix 1.

15. In accordance with the CIPFA Code of Practice on Treasury Management Appendix 2, sets out the framework that the Head of Finance (as the Council's s151 officer) will ensure is used to make individual investment decisions.

TREASURY MANAGEMENT – RISK ASSESSMENT

RAG indicator:

Red (R) - This is a risk that has a high potential to impact the Council and therefore should be actively being managed

Amber (A) - This is a risk which the Council needs to monitor, but is not viewed as having a high potential of impact on the Council

Green (G) - This is a risk that either does not apply to the Council, or is under sufficient control to be viewed as having a very low potential of impacting the Council

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
Credit & Counterparty	This is the key risk for the Council. The security of 'capital' investment is critical.	R	The Council uses Credit Ratings and other market intelligence to access the credit quality of any potential counterparty. The Council sets limits as to the minimum level of credit rating that it will accept for any individual counterparty. The current minimum levels are: Short-term (less then one year in duration) Fitch - F1 Standard & Poors - A-1 Moody's - P-1 Medium-term (greater than 1 year up to and including 3 years) Fitch A+ Standard & Poors A+ Moody's A1 Longer-term (greater than one year in duration up to and including 5 years) Fitch - AA-

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			Standard & Poors - AA- Moody's - Aa3 In addition all international banks we might want to invest in will need to be supported by guarantees from their national central banks and their national government will need to have their own sovereign rating of 'AAA'. The constitution of Money Market Funds means that they spread their investment over a wide range of counterparties and financial instruments which itself reduces the impact of this risk being realised. In addition these funds will be subject to either having UK Government guarantees or will have the following minimum credit rating. Fitch - AAA Standard & Poors- AAA Moody's - Aaa The Council sets a maximum exposure level, expressed in "£" that can be invested with any one organisation. The current limit is a maximum of £10m for some UK banks. UK Government securities or other Local authorities, parish or community councils form an exception, where exposure can be unlimited. To limit exposure in respect of Building Societies the Council will only invest with those societies with a

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			minimum asset base of over £1 billion pounds.
Liquidity	This is second key risk for the Council. To provide services it needs to ensure that it has money available when required and that the provision of the money should be delivered in the most cost effective way.	A	The Council maintains both an operational (1 year) and strategic (up to 5 years) Cash Flow model. Investment durations are then set to accord with when the money will be required according to the strategic cash flow model. Each transaction takes into account the underlying macro economic environment at the time the transaction is being considered.
Interest Rate	This is a potential risk to the Council of investing in transactions that have a 'variable' interest rate that might change over the duration of the transaction.	A	All 'cash' deposit transactions are undertaken on a 'Fixed-term' or 'Structured/stepped' deal basis which determines the interest rate and duration at the time the transaction is entered into.
Exchange Rate	This is not a risk for this Council, as all financial investment transactions are undertaken in '£' sterling.	G	Not applicable
Refinancing	This is an emerging risk for the Council.	A	Accurate records of loans will be maintained. Borrowing requirements will be planned well in advance of need to negotiate rates. The maturity profile of loans will be spread to reduce prospect of having to negotiate at a time that is unfavourable to the organisation.

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
Legal and Regulatory	This is a potential risk for the Council.	A	The Council's constitution and associated documentation (i.e. Financial Procedure Rules) clearly set out the governance framework within which Treasury Management activity is undertaken. The Council's Treasury Management Practice notes (TMP's) clearly set out roles and responsibilities and authorisation limits. In terms of the legal status of counterparties to deal with the Council, the Council relies upon advice from its Treasury Advisors and the fact that legal status is part of the elements that go to make up the 'credit rating' issued by the Rating Agencies. The 'Credit Quality' checks undertaken on all potential counterparties include a check that they are legally able to transact financial arrangements with public sector organisations. This is also mitigated by limiting the Council's counterparty list.
Fraud, error & Corruption and contingency management	This is a potential risk for the Council.	A	The Council's Treasury Management Practice notes (TMP's) clearly set out roles and responsibility and authorisation limits. All treasury transactions require the involvement of at least three Officers, split across two separate work teams (Treasury Management and Cash Management). Each with the power to defer any transaction taking place.

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			Internal audit undertake an annual independent audit on both the effectiveness of the Council's treasury management control arrangements and whether all the transactions that have been undertaken are compliant with the Treasury Management Policy, Treasury Management Strategy and the Treasury Management Practice.
Market risk	This is a potential risk for the Council.	A	As all 'cash' deposit transactions are undertaken on a 'Fixed-term' or 'Structured/stepped' basis this removes the potential of this risk occurring. All 'Gilt' investments are bought and held to maturity, this again removes the potential for this risk. As you buy a share in the value of the MMF at the time of investment, any downward movement in the relative share price could open the Council to a potential capital loss, but the likelihood of this occurring is low given that these funds by their nature invest in a wide range of financial instruments and financial institutions and earn their commission from increases in the share price.

Treasury Management Practice (TMP) 1 (1) – Credit and Counterparty Risk Management

1. The Office of the Deputy Prime Minister (now DCLG) issued investment guidance initially in March 2004, which was updated in 2010. These guidelines do not apply to either trust funds or pension funds, which are regulated by different regulatory regimes.

2. The key intention of the guidance is to maintain the requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication *Treasury Management in the Public Services: Code of Practice and Cross-Sector Guidance Notes*. This Council adopted the original Code on 31st March 2003 and the revised Code in April 2011. The principles of the new code have been applied within the Council's Treasury Management Policy Statement.

3. **Annual Investment Strategy -** The key requirement of both the Code and the investment guidance is to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

    i. The strategy guidelines for decision making on investments, particularly non-specified investments;

    ii. The principles to be used to determine the maximum periods for which funds can be committed;

    iii. Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year. This will need to define broad categories of investment and the regularity of monitoring;

    iv. Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

4. This strategy is to be approved by full Council. Items (i) to (IV) are addressed further in the following paragraphs.

5. **Strategy Guidelines** – The main strategy guidelines are contained in the body of the Treasury Strategy – Investment Strategy statement.

6. **Specified Investments** – These investments are sterling investments of not more than 365 day duration, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These should be low risk assets where the possibility of loss of principal or investment income is negligible. These would include investments with:

	Specified Investment Category (up to 365 day duration)	**Limit (£ or %)**
a.	**Securities fully backed by the UK Government.** This includes Debt Management Office, UK Treasury Bills or Gilts with less than one year to maturity and held to maturity.[1]	Unlimited
b.	**Local authority, parish council or community council**	Unlimited
c.	**Sterling Money Market Fund.** These Funds are solely invested in UK government securities or those backed by UK government securities and fully guaranteed by the UK Government	£5m per Fund
d.	**Money Market Fund.** These Funds should invest in a range of sectors and institutions to spread the risk of counter-party default. Access to funds should be immediate or overnight. Investments will be in organisations that have the following minimum credit ratings with all three Credit Rating Agencies Fitch AAA Moody's Aaa Standard & Poor AAA	£5m per Fund
e.	**Any UK Bank** that is regulated by the Prudential Regulation Authority (PRA) **and** has a minimum Short Term credit rating of the following rating with all the three Credit Rating Agencies Fitch F1 Moody's P-1 Standard & Poor A-1	Lower of £10m or 20% total investments with any individual counterparty
f.	**Any UK Building Society** that is regulated by the Prudential Regulation Authority **and** has a minimum of a £1billion asset base.	Lower of £10m or 20% total investments with any individual counterparty

7. Overall a minimum of £5m or 20%, whichever is the greater, of the Council's total investment should be invested in some form of specified investments to cover normal day-to-day cash flow requirements and unforeseen emergencies.

[1] Gilts will always be held to maturity

8. **Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not categorised as Specified above) with an investment duration that is (in most cases) greater than 365 days. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
g.	**Securities fully backed by the UK Government.** This includes Debt Management Office, Nationalised Banks, UK Treasury Bills or Gilt-edged securities with a maturity of greater than one year and held to maturity[2]. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	Unlimited
h.	**Local authority, parish council or community council**	£5m up to 3 years for an individual counterparty (up to a maximum of the lower of £10m or 20% of the portfolio)
i.	**UK Building Societies**, regulated by the Prudential Regulation Authority. The operating activities of some building societies are such that they do not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies but only if they have a minimum asset size of £1 Billion**.**	£5m up to 3 years for an individual counterparty
j.	**Any UK Bank**, regulated by the Prudential Regulation Authority that has a minimum long-term credit rating from all three of the Credit Rating Agencies; for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment). Minimum ratings Fitch AA Moody's Aa3 Standard & Poor AA-	£10m up to 5 years for an individual counterparty (or group)

[2] Gilts will always be held to maturity.

	Non Specified Investment Category	Limit (£ or %)
k.	**Any UK Bank**, regulated by the Prudential Regulation Authority that has a minimum long-term credit rating from all three of the Credit Rating Agencies; for deposits greater than one year (including forward deals in excess of one year from inception to repayment). Minimum ratings Fitch A+ Moody's A1 Standard & Poors A+	£5m up to 3 years for an individual counterparty (or group)
l.	**International Banks or Financial Institutions.** This will include organisations such as the World Bank, European Central Bank and other commercial banks/institutions where wholesale investments are fully guaranteed by the associated national government. These banks will have to possess as a minimum a following long term credit rating from all three of the Credit Rating Agencies. Fitch AA+ Moody's Aa1 Standard & Poor's AA+	£5m up to 3 years for an individual counterparty (or group)

9. **The Monitoring of Investment Counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating lists covering all three Credit Rating Agencies advice from its advisers, who issue daily updates as and when ratings change. These lists form the Council's counterparty list from which institutions are selected subject to them meeting the minimum criteria set in the above tables. On occasion ratings may be downgraded to below the minimum ratings or institutions are placed on negative credit watch. In either of these instances such institutions are not considered as acceptable counterparties for investment purposes.

ANNEX 2

REIGATE & BANSTEAD BOROUGH COUNCIL

BORROWING STRATEGY

2017 /18

BACKGROUND

1. The *Local Government Act 2003* requires the Council to adopt the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code and to produce "prudential indicators". Each indicator either summarises the expected capital and borrowing activity or introduces limits on that activity. The indicators are required to be approved by the Council as part of its annual review of Treasury Management activity.

2. The purpose of this Strategy is to set out the Council's position on the need to borrow money to fund its capital expenditure, or its cash flow, for the 2017/18 financial year.

PRUDENTIAL INDICATORS

Capital Expenditure Plans

3. The Council's capital expenditure plans are summarised in Table 1 and this forms the first of the prudential indicators. A certain level of capital expenditure may be grant supported by Government; any decisions taken to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure will need to have regards to:

   - Service objectives (e.g. strategic planning)
   - Stewardship of assets (asset management planning)
   - Value for money (e.g. options appraisal)
   - Prudence and sustainability (e.g. implications of external debt and whole life costing)
   - Affordability (e.g. implications for council tax)
   - Practicality (e.g. achievement of forward plan)

4. This expenditure can be paid for immediately (by resources such as capital receipts, capital grants etc.), but if these resources are insufficient any residual expenditure will create a borrowing need.

5. The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over time.

6. The Council approved the following capital expenditure programme as part of its budget for 2016/17.

Table 1: Capital Expenditure Programme

Capital Expenditure	2016/17 Projected £000	2017/18 Budget £000	2018/19 Forecast £000	2019/20 Forecast £000	2020/21 Forecast £000
Waste & Recycling Improvements	818	20.0	10.0	10.0	10.0
Environment	254.5	104.0	84.0	84.0	84.0
Capital Grants	1,109	660.0	660.0	660.0	660.0
Regeneration	6,508.8	3,735.0	207.0	0.0	0.0
Leisure & Culture	711.6	356.0	520.0	397.0	356.0
Strategic Property - Reserves	13,552.9	963.0	563.0	0.0	0.0
Strategic Property – Borrowing	0.0	30,000.0	10,000.0	0.0	0.0
Organisational Change	898.0	0.0	0.0	0.0	0.0
Organisation Change – Borrowing	0.0	10,000.0	30,000.0	0.0	0.0
Rolling Programmes	897.0	921.0	873.0	1,031.0	1,796.0
Total Capital Programme	**24,749.8**	**46,759.0**	**42,917.0**	**2,182.0**	**2,906.0**

7. The following approved projects which are already underway will necessitate borrowing of approximately £40m. We have also agreed loans to the property company, and headroom of at least £10m is required to allow for possible cash flow borrowing.

Table 2: Borrowing Requirement

Borrowing requirement	2016/17 Projected £000	2017/18 Budget £000	2018/19 Forecast £000	2019/20 Forecast £000	2020/21 Forecast £000
Loans to Property Company	0.0	0.0	8,000	0.0	0.0
Transfers to Property Company	0.0	2,000	2,000	0.0	0.0
Cash flow	0.0	0.0	10,000	0.0	0.0
Other investments	0.0	8,000	7,000	0.0	0.0
Contingency	0.0	0.0	3,000	0.0	0.0
Marketfield Way	0.0	30,000	10,000	0.0	0.0
Total Borrowing Requirement	**0.0**	**40,000**	**40,000**	**0.0**	**0.0**

The funding for the programme is outlined in the table below.

Table 3: Capital Expenditure Programme Financing

Capital Expenditure	2016/17 Projected £000	2017/18 Budget £000	2018/19 Forecast £000	2019/29 Forecast £000	2020/21 Forecast £000
Capital Reserves	10,615.8	5,592	1,750	1,015	1,739
Capital Grants and Contributions	13,634	667.0	667.0	667.0	667.0
Revenue	500.0	500.0	500.0	500.0	500.0
Total Financing	**24,749.8**	**46,759.0**	**42,917.0**	**2,182.0**	**2,906.0**
Net Financing Need*	0.0	40,000.0	40,000.0	0.0	0.0

*The Council's borrowing need (the change in capital financing requirement excluding sums set aside for redemption of debt).

Capital Financing Requirement

8. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total capital expenditure which has not been paid for from Council resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure which has not immediately been paid for will increase the CFR.

9. The Council is asked to approve the CFR projections in table 4.

Table 4: Projected Capital Financing Requirement

	2016/17 Projected £000	2017/18 Budget £000	2018/19 Forecast £000	2019/20 Forecast £000	2020/21 Forecast £000
Capital Financing Requirement (brought forward)	0	0	39,700	79,303	78,910
Borrowing Requirement (from Table 3)	0	40,000	40,000	0	0
Minimum Revenue Provision (MRP)	0	300	397	393	389
Capital Financing Requirement (carried forward)	**0**	**39,700**	**79,303**	**78,910**	**78,521**

10. The Council has no PFI or finance lease liabilities; if it were to enter into any of these schemes the accounting treatment would require the long term liability to be included in the CFR calculations.

11. The Council is required to pay off an element of the accumulated CFR each year through a revenue charge (the 'Minimum Revenue Provision' or MRP) although it is allowed to undertake additional, voluntary payments.

12. DCLG Regulations require the Council to approve an MRP Statement each year. The Council is recommended to approve the following.

MRP Statement

13. Regulation 28 of the 2003 regulations (as amended by regulation 4 of the 2008 regulations) requires a local authority to calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent.

14. The Secretary of State recommends that, for the purposes of the regulations, the prudent amount of provision should be determined with the broad aim of ensuring that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits.

15. In order to achieve this aim, the Council will determine the MRP for the year by what is termed an Asset Life Method, which is summarised below.

16. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be made in equal annual instalments over the life of the asset, in accordance with the following formula:

$$\frac{\mathbf{A - B}}{\mathbf{C}}$$

Where:

A – is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements

B – is the total provision made before the current financial year in respect of that expenditure

C – is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

17. The only exceptions to the approach above will be:

- For investment properties held for income-generation purposes, MRP of 1% will be made.
- For investment properties held solely for capital-appreciation purposes with an intention to sell, no MRP will be charged.
- For loans taken to provide debt finance for capital projects undertaken for the Council by other parties (eg the property company), no MRP will be charged.

Affordability Prudential Indicators

18. In order to consider the affordability of its capital plans, all resources currently available and estimated in the future should be considered. Set out below are the key indicators for affordability.

19. **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 liability costs net of investment income) against the net revenue stream. For 2017/18 investment income is expected to exceed borrowing costs so this indicator is not relevant.

20. **Estimates of the incremental impact of capital investment decisions on the council tax** – this indicator identified the revenue costs associated with proposed changes to the capital programme recommended in this budget report. However, as the capital programme is to be financed from internal resources there will be no impact on council tax in 2017/18.

Borrowing limit indicators

21. Within the Prudential Code there are a number of key indicators to ensure the Council operates within well-defined borrowing limits.

22. For the first of these the Council needs to ensure that its total gross borrowing 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 next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

23. The Council has complied with this Prudential Indicator during 2016/17 and there are no difficulties anticipated for the following financial year. This view takes into account current commitments, existing plans, and the proposals in this report.

24. A further two Prudential Indicators control the overall level of borrowing. These are:

    The authorised limit: this represents the limit beyond which borrowing is prohibited. It reflects a level of borrowing that could be afforded in the short term, but that is neither sustainable nor desirable. It is the expected maximum borrowing need with some headroom for unexpected events.

Table 4: Authorised Limit for Borrowing

	2016/17 Budget £000	2017/18 Budget £000	2018/19 Forecast £000	2019/20 Forecast £000	2020/21 Forecast £000
Authorised Limit for External Debt	35,000	80,000	80,000	80,000	80,000

The operational boundary: this indicator is based upon the probable external debt during the course of the year. It is not a limit and actual borrowing could exceed this boundary for short times during the year. It should, however, act as an indicator to ensure the authorised limit is not breached.

Table 5: Operational Boundaries for Borrowing

	2016/17 Budget £000	2017/18 Budget £000	2018/19 Forecast £000	2019/20 Forecast £000	2020/21 Forecast £000
Operational Boundary for External Debt	25,000	70,000	70,000	70,000	70,000

25. The last Prudential Indicator relating to borrowing provides upper limits for fixed and variable interest rate exposure. Since the Council only intends to undertake borrowing at fixed interest rates these will be set at 100% fixed and 0% variable.

26. In addition to the prudential controls above, the Finance Manager (as the Council's s151 officer) is also required to ensure that the Council, as part of its day-to-day treasury operations, does not "on lend" (ie borrow money to invest elsewhere).

ANNEX 3

REIGATE & BANSTEAD BOROUGH COUNCIL

CASH MANAGEMENT STRATEGY

2017 / 2018

OBJECTIVES

1. The purpose of the Council's cash management strategy is to optimise the flow of cash through the organisation in order to maximise the potential for using it to earn income for the Council.

2. To optimise cash flow, the Council manages both its outflows and inflows:

   - Outflows (expenditure): payment to suppliers, employees and other creditors.
   - Inflows (income): the identification and collection of money owed to the Council.

3. Effective management of the processes handling the inflows and outflows is a key element of this strategy. The financial policies of the Council are set out in the Financial Procedural Rules within the Constitution. These describe the key control requirements.

4. In addition to sound and well controlled processes it is important that these processes are as efficient as possible. This is achieved through standardised best practice processes.

5. In essence the aim is to keep transactional costs low and quality high by automating and embedding standardised best practice processes in all financial activity across the Council.

6. This involves:

   - Identifying and establishing the one standard process to be used across the Council to deliver best practice
   - Automating, where possible and cost-effective to do so, thereby increasing productivity and embedding controls, reducing risk of error and the resultant cost of putting it right
   - Minimising cash transactions thereby reducing both risk and handling costs
   - Maintaining good customer care, treating all customers fairly, consistently and with respect; and dealing with all queries promptly
   - Continuous improvement of the efficiency and effectiveness of the systems and processes.

7. Objectives specific to the function are as follows:

Payment to Suppliers

- Timely payment of suppliers. This means ensuring payment is made in accordance with the contractual terms of business, taking full advantage of available 'credit' periods but avoiding late payments and potential interest cost under the *Late Payment of Commercial Debts (Interest) Act 1998.*

Collection of Debts

- To ensure that all money owed to the Council is properly and promptly recorded within the Council's debtor systems.
- To take all effective actions to ensure that the money owed is actually received by the Council and as quickly as possible.

Receipts Handling & Banking

- To ensure cash and cheques received are deposited in the Council's bank accounts as promptly as possible.
- To maximise electronic payments.

PERFORMANCE MEASURES / SUCCESS MEASURES

Payment to Suppliers

8. Currently 98% of payments are made to suppliers within the contractual timescales against a target of 98%.

9. Electronic payment is efficient, benefiting the Council, and prompt, benefiting the supplier. The Council currently pays 99.8% of the volume of supplier invoices it receives electronically against a target for 2016/17 of 98%.

Collection of Debts

10. The Council already has an excellent record for the recovery of debt; performance is reported to the Executive to help ensure this is maintained.

11. The current economic situation is likely to have an ever increasing effect on debt recovery as more organisations and individuals encounter difficulties. Maintaining the high recovery and low write off rates will be a challenge.

Receipt Handling & Banking

12. Currently, over 99% of income received by the central income office team is processed and/or banked within 2 working days.

13. The target for 2017/18 is to at least maintain these performance levels.

ANNEX 4

REIGATE & BANSTEAD BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY RISK MANAGEMENT ASSESSMENT

2017 / 2018

PURPOSE

1. The Council's Treasury Management Policy Statement requires that risk issues are fully considered in the development of the Council's Treasury Management Strategy.

2. The Code of Practice on Treasury Management identifies eight key areas of risks that all Public Sector organisations should consider when developing their strategies. These are:

   - Credit & counterparty risk management
   - Liquidity risk
   - Interest rate risk
   - Exchange rate risk
   - Refinancing risk
   - Legal & regulatory risk
   - Fraud, error, corruption & contingency management
   - Market risk

3. The purpose of this statement is to set out the Council's current position regarding the potential impact that the above risks will have on its Treasury Management activity during 2017/18.

RISK ASSESSMENT

Credit & Counterparty Risk

4. This is the risk of failure by a Counterparty to meet its contractual obligations to the Council under an investment, borrowing or other financing agreement; particularly as a result of the counterparty's diminished creditworthiness.

5. This is the main risk faced by all public sector organisations. Therefore the Council needs to ensure that it has appropriate controls in place to both avoid entering agreements with Counterparties that are showing the signs of financial problems and to minimise any impact on the Council should the risk materialise by limiting the value of any potential exposure.

6. Given continuing concerns over the need to maintain security and guarantee assurance about the safety of the capital investment, this creates a risk that the "credit quality" requirements will limit the number of potential counterparties to an extent that the Council is forced to invest in organisations and institutions (such as the Debt Management Office) where investment returns would be very low.

7. Another example of this is the negative impact on UK banks and building societies associated with the UK's decision to leave the European Union (EU). Lower economic growth, and increased uncertainty over the UK's trade relationship with the EU is likely to lead to reduced demand for credit and higher credit losses which may impact the "credit quality" of counterparties.

Liquidity Risk

8. This is the risk that cash will not be available when it is actually needed to make payments.

9. The Council maintains monthly, annual and 5-year cash flow models which help to identify when cash will be required.

10. The authorised borrowing limit provides cover for any short-term cash flow issues that arise.

Interest Rate Risk

11. This is the risk that movements in interest rates will adversely affect the financial position of the authority. As all the Council's investments are fixed rate or structured/stepped this avoids immediate exposure to fluctuations in interest rates. The maturity profile on investments and the use of investment managers also reduces the impact when the investment matures and requires placement back into the market.

12. The table below highlights the estimated impact of a full percentage point increase/decrease in all interest rates to treasury management costs/income for next year. The figures are based on all the investments that are due to come to maturity within the next twelve months.

Table 1: Impact of Changes in Interest Rates

	2017/18 Estimated + 1% Point	**2017/18 Estimated - 1% Point**
Revenue Budgets		
Interest on (long-term) borrowing	0	0
Investment income	£430,000	-£430,000

Exchange Rate Risk

13. This risk relates to the potential loss of money from fluctuations in foreign exchange rates where money has been traded in other national currencies. This is not applicable as the Council's current policy is to only invest or borrow money in Sterling.

Refinancing Risk

14. This relates to borrowing money, and reflects the risk that maturing borrowing arrangements cannot be refinanced on terms that reflect the provision made for refinancing and that the terms may not be consistent with prevailing market conditions at the time.

15. This is an emerging risk for this Council, which will be managed though indicators associated with the authorities exposure to refinancing risk..

Legal & Regulatory Risk

16. This is the risk that the Council or an organisation that is it dealing with, fails to act in accordance with its legal powers or regulatory requirements and that the Council suffers losses accordingly.

17. The Council's Constitution, through its Financial Procedure Rules together with the Council's Treasury Management Policy Statement provides the governance framework to ensure that the Council acts at all time in a legal manner.

18. The 'credit quality' checks undertaken on all potential counterparties include a check that they are legally able to transact financial arrangements with public sector organisations. This is also mitigated by limiting the Council's counterparty list.

Fraud, Error, Corruption & Contingency Management Risk

19. This risk relates to the failure of the Council to identify the circumstances in which it may be exposed to the risk of loss through fraud, error or corruption or other eventualities in its treasury management dealings - and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. This is commonly referred to as 'operational' risk.

20. It is difficult for any public sector organisation to fully protect itself against these risks. The most effective way is to ensure that it has fully robust and fully documented procedures that ensure that more than one person is involved in any treasury management transaction.

21. The Council's procedures are set out in its Treasury Management Practice statements which are reviewed regularly by Senior Management.

22. In addition, Internal Audit undertakes an annual review to ensure that all transactions comply with documented procedures and the Council's Treasury Management Policy Statement. The Overview and Scrutiny Committee receive Internal Audit reports.

Market Risk

23. Market risk is defined as the possibility that the value of an instrument (investment) will fluctuate because of changes in market conditions. As the Council only deals in fixed term arrangements where the interest rate liability is fixed (or fixed periodically within a range for stepped investments), then this risk is not applicable.

CONCLUSION

24. . To further understand the impact of these risks, and the control measures in place to mitigate them, a risk assessment schedule is set out at the end of the Investment Strategy (Appendix 1).

25. Overall this shows that the Council has a clear understanding of the potential risks and has fully considered ways of addressing them.