Committee and Date	
Cabinet 10 February 2016 Audit Committee 18 February 2016 Council 25 February 2016	**10**

TREASURY STRATEGY 2016/17

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1. Summary

1.1 The report proposes the Treasury Strategy for 2016/17 and recommends Prudential Indicators for 2016/17 to 2018/19. The report is technical in nature but the key points to note are:-

- Borrowing is largely driven by the Capital Programme Strategy. From 2011/12 the Council's borrowing requirement has been significantly reduced due to the Government changing the way in which it funds the Council's capital expenditure and providing capital grants rather than supported borrowing approval with on-going revenue support grant to meet the financing costs of the borrowing. There is currently no borrowing required in future years based on the current Capital Programme and the continued policy of generating additional capital receipts to fund capital expenditure.

- The Council's lending continues to be restricted to highly credit rated Banks, three Building Societies, Nationalised and Part Nationalised Institutions which meet Capita's creditworthiness policy, other Local Authorities and the UK Government.

- The internal Treasury Team will continue to look for opportunities to make savings by actively managing the cash and debt portfolio in accordance with the Treasury Strategy.

- The bank rate is expected to remain at its historically low level of 0.50% until December 2016 when it is forecast to rise to 0.75%. Every 0.25% increase in the bank rate equates to around £375,000 of additional interest receivable per annum on the Council's investments.

- Long term borrowing rates are expected to be higher than investment rates during 2016/17 therefore long term borrowing may be postponed in order to maximise savings in the short term. No external borrowing is currently expected to be undertaken in 2016/17 or future years due to a review of the Capital Programme.

- The Council has agreed to offer to lend funds to Shropshire Housing Ltd (which incorporates both South Shropshire Housing Association and the Meres & Mosses Housing Association) and Severnside Housing at an agreed rate. In the current climate Housing Associations can find it difficult to obtain funding for new affordable housing. It has been agreed to offer to lend up to £10 million to each of these Housing Associations in order to support the building of affordable housing and shared office accommodation in Shropshire. For security purposes, each loan will be secured against existing assets held by or owned by the Housing Association. To date £9,770,000 has been drawn down by Shropshire Housing Ltd and £2,280,000 by Severnside Housing. Severnside Housing are looking to draw down their remaining outstanding balance by 31 March 2016.

2. Recommendations

2.1. Recommendations to Cabinet

Cabinet recommend that Council:-

a) Approve, with any comments, the Treasury Strategy for 2016/17.

b) Approve, with any comments, the Prudential Indicators, set out in Appendix 1, in accordance with the Local Government Act 2003.

c) Approve, with any comments, the Investment Strategy, set out in Appendix 2 in accordance with the CLG Guidance on Local Government Investments.

d) Approve, with any comments, the Minimum Revenue Provision (MRP) Policy Statement, set out in Appendix 3.

e) Authorise the Section 151 Officer to exercise the borrowing powers contained in Section 3 of the Local Government Act 2003 and to manage the Council's debt portfolio in accordance with the Treasury Strategy.

f) Authorise the Section 151 Officer to use other Foreign Banks which meet Capita's creditworthiness policy and Money Market Funds again as required.

g) Note the proposed Prudential Indicators would enable the Authority to use the equivalent of up to 3% of Council Tax in 2016/17 or future years, to fund borrowing under the Prudential Code should the Council decide to do so.

2.2. Recommendations to Audit Committee

h) Audit Committee are asked to consider and endorse, with appropriate comment, the Treasury Strategy 2016/17.

2.3. Recommendations to the Council

i) Approve, with any comments, the Treasury Strategy for 2016/17.

j) Approve, with any comments, the Prudential Indicators, set out in Appendix 1, in accordance with the Local Government Act 2003.

k) Approve, with any comments, the Investment Strategy, set out in Appendix 2 in accordance with the CLG Guidance on Local Government Investments.

l) Approve, with any comments, the Minimum Revenue Provision (MRP) Policy Statement, set out in Appendix 3.

m) Authorise the Section 151 Officer to exercise the borrowing powers contained in Section 3 of the Local Government Act 2003 and to manage the Council's debt portfolio in accordance with the Treasury Strategy.

n) Authorise the Section 151 Officer to use other Foreign Banks which meet Capita's creditworthiness policy and Money Market Funds as required.

o) Note the proposed Prudential Indicators would enable the Authority to use the equivalent of up to 3% of Council Tax in 2016/17 or future years, to fund borrowing under the Prudential Code should the Council decide to do so.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1 The financial implications arising from the Treasury Strategy are detailed in this report. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in the year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.

4.2 The Council currently has £140.2 million held in investments and borrowing of £329.0 million at fixed interest rates.

5. Background

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

5.2. This strategy statement has been prepared in accordance with CIPFA's Code of Practice on Treasury Management. Accordingly, the Council's Treasury Strategy will be approved annually by full Council and there will also be a mid year review report. In addition, treasury management update reports will be submitted quarterly to Directors and Cabinet. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of policies and practices, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

5.3. The Council will adopt the following reporting arrangements in accordance with the requirements of the Code:-

Area of Responsibility	**Council/Committee/Officer**	**Frequency**
Treasury Management Policy Statement	Full Council/Cabinet	As required
Treasury Strategy/Annual Investment Strategy/MRP Policy	Full Council/Cabinet	Annually before the start of the financial year
Treasury Strategy/Annual Investment Strategy/MRP Policy – mid year report	Full Council/Cabinet	Mid year
Treasury Strategy/Annual Investment Strategy/MRP Policy – updates or revisions at other times	Full Council/Cabinet	As required
Annual Treasury Report	Full Council/Cabinet	Annually by 30 September after the end of the financial year
Treasury Management Monitoring Reports	Reports prepared by Investment Officer to the Head of Treasury & Pensions who reports to the Section151 Officer	Monthly
Treasury Management Practices	Section 151 Officer	As required
Scrutiny of Treasury Strategy	Audit Committee	Annually before the start of the financial year
Scrutiny of the treasury management performance	Audit Committee	Half yearly

6. **Treasury Strategy 2016/17**

6.1. The Local Government Act 2003 and supporting Regulations requires the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that capital investment plans are affordable, prudent and sustainable. This report incorporates the indicators to which regard should be given when determining the Council's Treasury Management Strategy for the next financial year.

6.2. As the Council is responsible for housing, Prudential Indicators relating to Capital Expenditure, financing costs and the Capital Financing Requirement will be split between the Housing Revenue Account (HRA) and the General Fund. The impact of any new capital investment decisions on housing rents will also need to be considered.

6.3. The Act also requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

6.4. The proposed Strategy for 2016/17 in respect of the following aspects of the treasury management function is based upon the S151 Officers' view on interest rates, supplemented with leading market forecasts provided by the Council's Treasury Advisor, Capita Asset Services.

6.5. The proposed strategy will focus on the following areas of treasury activity:-

- Treasury limits in force which will limit the treasury risk and activities of the Council.
- The determination of Prudential and Treasury Indicators.
- The current treasury position.
- Prospects for interest rates.
- Capital borrowing strategy.
- Policy on borrowing in advance of need.
- Debt rescheduling.
- Investment strategy.
- Capital plans.
- Creditworthiness policy.
- Policy on use of external service providers.
- The MRP strategy.
- Leasing.

6.6. 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 increase in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

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

7.1. It is a statutory requirement under Section 3 of the Local Government Act 2003 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". This authorised limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

7.2. 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 levels is 'acceptable'.

7.3. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Borrowing Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years and is the limit which the Council must not breach. All of the other Prudential Indicators are estimates only and can be breached temporarily but this is very rarely the case. If this did happen it would be reported to Members outlining the reasons for this temporary breach.

7.4. The Council are asked to approve these Prudential Indicators.

8. Prudential & Treasury Indicators for 2016/17 to 2018/19

8.1. The Prudential Code and CIPFA Code of Practice on Treasury Management require the Council to set a number of Prudential and Treasury Indicators. In addition to the specified indicators, we have set 4 further internal indicators for Treasury Management, regarding lower limits on interest rate exposure for both borrowing and investments.

8.2. It should be noted that these indicators should not be used for comparison with indicators from other local authorities. Use of them in this way would be likely to be misleading and counter-productive as other authorities Treasury Management policies and practices vary. The most important indicator is prudential indicator number 10 which specifies the authorised limit which cannot be breached under any circumstances. In the event that this indicator was breached a separate report would be brought to Council.

8.3. **Prudential Indicator 1 & 2** - The ratio of financing costs indicator shows the trend in the cost of financing capital expenditure as a proportion of the Authority's net revenue. This indicator also shows the ratio of the HRA financing costs to the HRA net revenue stream.

Prudential Indicator No. 1 & 2	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
	%	**%**	**%**	**%**
Non HRA ratio of financing costs (gross of investment income) to net revenue stream	10.2	8.9	8.6	8.2
Non HRA ratio of financing costs (net of investment income) to net revenue stream	9.6	8.3	8.0	7.6
HRA Ratio of financing costs to HRA net revenue stream	41.3	40.0	40.9	41.9

8.4. The 2016/17 to 2019/20 Capital Budget includes no prudential borrowing for 2016/17 or future years.

8.5. **Prudential Indicator 3** - In accordance with Prudential Guidelines the costs of all prudential borrowing are included in prudential indicators, even though they will be funded from existing revenue budgets. The HRA budgetary requirements for the authority have also been calculated by taking the difference between the existing capital programme and any changes proposed in the new capital programme. It is anticipated that there will be no unsupported borrowing relating to the HRA therefore the addition or reduction to average weekly housing rents for 2016/17 to 2018/19 is zero. The figures quoted include Prudential Borrowing already utilised and profiled totalling £28.8 million from 2006/07 to 2016/17.

Prudential Indicator No. 3	**2016/17**	**2017/18**	**2018/19**
Estimates of impact of Capital Investment decisions in the present capital programme	**£ p**	**£ p**	**£ p**
Cost of capital investment decisions funded from re-direction of existing resources (Band D, per annum)	23.64	20.32	19.31
Cost of capital investment decisions funded from increase in council tax (Band D, per annum)	0	0	0
Cost of capital investment decisions funded from increase in average housing rent per week	0	0	0
Total	**24.86**	**21.46**	**19.31**

8.6. **Prudential Indicator 5, 8, 9** - A key indicator of prudence is that net external borrowing should not, except in the short term, exceed the capital financing requirement (CFR). The capital financing requirement is the maximum we would expect to borrow based on the current capital programme. Compliance with the indicator will mean that this limit has not been breached. From 2013/14 onwards the key indicator of prudence has been revised and stipulates that gross borrowing, except in the short term, should not exceed the CFR. The reason gross borrowing is currently above the Capital Financing Requirement from 2016/17 is due the authority setting aside capital receipts until they are required and following the change from borrowing approvals to capital grants annual Minimum Revenue Provision payments are higher than the level of maturing debt each year meaning the CFR is reducing more than the gross borrowing. Gross borrowing includes debt administered on behalf of the Borough of Telford and Wrekin, Magistrates Courts and Probation Service. It also includes the debt transferred from Oswestry Borough Council and North Shropshire District Council on the 1st April 2009. In accordance with the Code the HRA Capital Financing requirement has been calculated separately and has been updated due to the HRA reform which is took place on the 28 March 2012.

Prudential Indicator No. 5 * No. 8 & 9^	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Net Borrowing & Capital Financing Requirement:	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**
Non HRA Capital Financing Requirement^	246	253	246	240	233
HRA Capital Financing Requirement^	85	85	85	85	85
Total CFR	**331**	**338**	**331**	**325**	**318**
Gross Borrowing including HRA*	338	329	324	318	312
Investments*	110	140	140	140	140
Net Borrowing*	**238**	**189**	**184**	**178**	**172**

8.7. **Prudential Indicator 6 & 7** - The estimated capital expenditure has been split between Non HRA and HRA and represents commitments from previous years to complete ongoing schemes, the expenditure arising from the proposed new schemes within the capital programme for 2016/17, and the estimated expenditure for 2017/18 and 2018/19.

Prudential Indicator No. 6 & 7	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£ m	**£ m**	**£ m**	**£ m**	**£ m**
Non HRA Capital expenditure	45	46	49	27	16
HRA Capital expenditure	9	5	7	4	0

8.8. **Prudential Indicator 10 which must not be breached** - The authorised limit is the borrowing limit set for Shropshire Council and includes the HRA borrowing. This indicator shows the maximum permitted amount of outstanding debt for all purposes. It includes three components:

1. The maximum amount for capital purposes;
2. The maximum amount for short term borrowing to meet possible temporary revenue shortfalls;
3. The maximum permitted for items other than long term borrowing i.e. PFI & leasing.

Prudential Indicator No. 10	2016/17	2017/18	2018/19
External Debt	**£ m**	**£ m**	**£ m**
Authorised Limit for External Debt:			

Borrowing Other long term liabilities	449 80	432 86	412 85
Total	**529**	**518**	**497**

8.9. Separately, the Council is also limited to a maximum HRA debt limit through the HRA self-financing regime. This limit is as follows:

Prudential Indicator	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£ m	**£ m**	**£ m**	**£ m**
HRA Debt Limit	96	96	96	96

8.10. **Prudential Indicator 11 –** The more likely outcome for the level of external debt is shown in the operational boundary which the Council is required to set. This is calculated on the same basis as prudential indicator number 10, however, this is the limit which external debt is not normally expected to exceed.

Prudential Indicator No. 11	**2016/17**	**2017/18**	**2018/19**
External Debt	**£ m**	**£ m**	**£ m**
Operational Boundary: Borrowing Other long term liabilities	 402 80	 370 86	 379 85
Total	**482**	**456**	**464**

8.11. **Prudential Indicator 12** - The estimated external debt is based on the capital programme for 2015/16.

Prudential Indicator No. 12	**31/03/15 Actual**	**31/03/16 Estimate**
Actual External Debt	**£ m**	**£ m**
Borrowing Other long term liabilities	338 23	329 82
Total	**361**	**411**

8.12. **Prudential Indicator number 13** relates to the Local Authority adopting the CIPFA Code of Practice for Treasury Management in Public Services. The original 2001 Code was adopted by full Council in February 2002. Shropshire Council adopted the revised Code in February 2010.

8.13. **Prudential Indicator 14 & 15 -** The Prudential Code requires the Council to set interest rate exposure limits for borrowing and investments.

Prudential Indicator No. 14* Internal Indicator No. 1 ** No. 15 ^ Internal Indicator No. 2 ^^	**2016/17**	**2017/18**	**2018/19**
Borrowing Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure *	449	432	412
Upper Limit for Variable Interest Rate Exposure ^	225	216	206
Lower Limit for Fixed Interest Rate Exposure **	224	216	206
Lower Limit on Variable Interest Rate Exposure ^^	0	0	0

These indicators seek to control the amount of debt exposed to fixed and variable interest rates. Variable rate debt carries the risk of unexpected increases in interest rates and consequently increases in cost. The upper limit for variable rate exposure has been set following advice from Capita, however, this limit is never likely to be reached due to authority's objective to have no more than 25% of outstanding debt at variable interest rates.

Upper limit for fixed rate exposure
Calculation: A maximum of 100% of the Authorised Limit (£449m in 2016/17) exposed to fixed rates is consistent with the Authority's objective to have a long term stable debt portfolio.

Upper limit for variable rate exposure
Calculation: For efficient management of the debt portfolio it is considered prudent by Capita to permit up to 50% (£225m in 2016/17) of the Authorised Limit to be borrowed at variable interest rates.

Lower limit for fixed rate exposure
Calculation: Upper limit for fixed rate exposure less the maximum permitted borrowing at variable interest rates

Lower limit for variable rate exposure

Calculation: To be consistent with the Authority's objective to have a long term stable portfolio all of the debt portfolio could be at a fixed rate therefore the lower limit for variable rate exposure should be nil.

Prudential Indicator No. 14* Internal Indicator No. 3 ** No. 15 ^ Internal Indicator No. 4 ^^	**2016/17**	**2017/18**	**2018/19**
Investment Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure *	200	200	200
Upper Limit for Variable Interest Rate Exposure ^	200	200	200
Lower Limit for Fixed Interest Rate Exposure **	0	0	0
Lower Limit on Variable Interest Rate Exposure ^^	0	0	0

These indicators seek to control the amount of investments exposed to fixed and variable interest rates. Variable rate investments are subject to changes in interest rates, but have a higher degree of liquidity and action can be taken at short notice in response to interest rate changes.

Upper limit for fixed rate exposure
Calculation: Maximum amount of fixed rate investments in order to maintain a stable investment portfolio.

Upper limit for variable rate exposure
Calculation: For the purposes of efficient portfolio management in response to interest rate conditions a maximum potential exposure to variable rates of £200m in 2016/17 is recommended.

Lower limit for fixed rate exposure
Calculation: A lower limit of zero is locally set so as to enable full advantage to be taken of market conditions.

Lower limit for variable rate exposure
Calculation: A lower limit of zero is locally set so as to enable full advantage to be taken of market conditions.

8.14. **Prudential Indicator 16** - The upper and lower limit for the maturity structure of borrowings is detailed below.

Prudential Indicator No. 16	**Upper Limit**	**Lower Limit**
Maturity Structure of Fixed Rate Borrowing 2016/17*	**%**	**%**

Under 12 months	15	0
12 months & within 24 months	15	0
24 months & within 5 years	45	0
5 years to 10 years	75	0
10 years to 20 years	100	0
20 years to 30 years	100	0
30 years to 40 years	100	0
40 years to 50 years	100	0
50 years and above	100	0

- **The internal limit is to have no more than 15% of total outstanding debt maturing in any one financial year. This is to ensure that the risk of having to replace maturing debt at times of high interest rates is controlled.**

8.15. **Prudential Indicator 17 -** The Council is required to set maximum levels for investments over 364 days for both the internal treasury team and an external fund manager if appointed.

Prudential Indicator No. 17	2016/17	2017/18	2018/19
Investment Limits			
	£m	£m	£m
Upper Limit for Total Principal Sums Invested for over 364 days:			
Externally Managed (if appointed)	30	30	30
Internally Managed	40	40	40

Rationale: The limit for the external cash fund manager has been set at £30 million in the event that an external manager is appointed. The limit for the internal treasury team has been set in order for the authority to potentially take advantage of more stable returns going forward and the potential to lend to local Housing Associations.

9. Current Treasury Position

9.1. The Council's treasury position at 31 December 2015 is set out below:-

Outstanding debt for capital purposes	**Actual £m**
Long-term fixed rate PWLB	279.8
Long term fixed rate – Market	49.2
Total	**329.0**

Investments	**£m**
Internally managed - long term (1 Year)	41.2
- short term cash flow	99.0
Total	**140.2**

10. Prospects for Interest Rates

10.1. The Council retains the services of Capita Asset Services as adviser on treasury matters and part of the service provided is to help the Council to formulate a view on interest rates. The following table gives the latest Capita central view:-

Capita's interest rate forecast as at January 2016

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

As no new external borrowing is required the Council has not budgeted for a cost of borrowing in 2016/17 to 2018/19, as any borrowing will be funded from internal borrowing. Interest received on revenue balances is expected to be 0.60% in 2016/17.

Sector's current interest rate view is that Bank Rate will: -

- rise from its current level of 0.50% to 0.75% in December 2016.
- reach 1.25% by December 2017.
- rise to 1.75% by December 2018.

The effect on interest rates for the UK, is expected to be as follows:-

Short-term interest rates (investments)

10.2. Taking all the evidence together, it is felt that the bank rate will remain at its current low level of 0.5% until December 2016 when it is expected to rise to 0.75%. The Bank rate is then expected to rise steadily to 1.25% by December 2017. As the threat of potential risks from a number of sources still remains, caution must be exercised in respect of all interest rate forecasts at the current time. Capita's Bank Rate forecasts will be liable to further amendment depending on how economic data transpires over 2016.

Long-term interest rates (borrowing)

10.3. The 50 year PWLB rate is expected to rise gradually to reach 3.5% by the end of the March 2017. It is then anticipated to rise further to reach 4% by the end of March 2019. There is scope for it to move around the central forecast by + or – 0.25%. The 25 year PWLB rate is also expected to rise gradually to reach 3.7% by the end of March 2017 and 4.1% by the end of March 2019. The 10 year PWLB rate is expected to rise to reach 3% by the end of March 2017. Again further rises are expected in 2017/18 & 2018/19. The 5 year PWLB rates are also expected to rise from 2% to 2.4% by the end of March 2017 and to 3.2% by the end of March 2019. The PWLB rates and forecasts shown above take into account the 0.2% certainty rate reduction effective as of the 1 November 2012.

11. Capital Borrowing Strategy

11.1. The Council currently does not have an external borrowing requirement for 2015/16 to 2017/18 but based upon the prospects for interest rates outlined above, the Council will adopt a pragmatic approach to changing circumstances when considering new borrowing if required in the future. Consideration will be given to the following:-

i) As long term borrowing rates are expected to be higher than investment rates and look likely to be for the next couple of years or so all new external borrowing may be deferred in order to maximise savings in the short term. The running down of investments also has the added benefit of reducing exposure to interest rate and credit risk. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing up the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years.

ii) Temporary borrowing from the money markets or other local authorities.

iii) PWLB variable rate loans for up to 10 years.

iv) Long term fixed rate market loans (including loans offered by the Municipal Bond Agency) at rates below PWLB rates for the equivalent maturity period.

v) Short term PWLB rates are expected to be significantly cheaper than longer term borrowing therefore borrowing could be undertaken in the under 10 year period early on in the financial year when rates are expected to be at their lowest. This will also have the added benefit of spreading debt maturities away from a concentration in longer dated debt.

vi) If it was felt that there was a significant risk in a sharp fall in long and short term rates then long term borrowings will be postponed. If it was felt there was a significant risk of a sharp rise in long and short term rates then the portfolio position would be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

11.2. Delegated authority is sought for the Section 151 Officer to exercise the borrowing powers contained in the Local Government Act 2003 to manage the debt portfolio.

12. External versus internal borrowing

12.1. The Prudential Code requires the Council to explain its policy on gross and net debt. The Council currently has gross debt of £329 million and net debt (after deducting cash balances) of £188.8 million. The next financial year is expected to see the Bank Rate rise to 0.75% from the current historically low level of 0.5%. As borrowing rates are expected to be higher than investment rates this would indicate that value could best be obtained by avoiding new external borrowing and using internal cash balances to finance new capital expenditure. This is referred to as internal borrowing and would maximise short term savings.

12.2. However, by delaying unavoidable new external borrowing until later years when PWLB rates are forecast to be higher will mean the potential for incurring additional long term costs.

12.3. The Council has examined the potential for undertaking early repayment of some external debt in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower rates for repayments than for new borrowing means that large premiums would be incurred and such levels of premiums cannot be justified on value for money grounds.

12.4. Against this background caution will be adopted with the 2016/17 treasury operations. The Section 151 Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Members at the next available opportunity.

13. Policy on borrowing in advance of need

13.1. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

13.2. In determining whether borrowing will be undertaken in advance of need the Council will:-

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- Consider the merits and demerits of alternative forms of funding.
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.
- Consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balance and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

14. Debt Rescheduling

14.1. The introduction of a differential in PWLB rates on 1 November 2007, which has been compounded further since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates following the Chancellor's announcement to increase new borrowing rates by up to 1% following the Comprehensive Spending Review, has meant that large premiums would be incurred if debt restructuring is undertaken which cannot be justified on value for money grounds. However, consideration will be given to the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates currently paid on debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action. The proposals for debt rescheduling are a continuation of the existing policy and such transactions will only be undertaken:-

- in order to generate cash savings at minimum risk.
- to help fulfil the strategy set out above.
- in order to enhance the balance of the long term portfolio by amending the maturity profile and/or volatility of the portfolio.

15. Investment Strategy

15.1. The Council is required, under CIPFA's Treasury Management Code of Practice, to formulate an Annual Investment Strategy (Appendix 2). This outlines the Council's approach to:-

- Security of capital
- Creditworthiness policy
- Monitoring of credit ratings
- Specified and Non Specified Investments
- Temporary Investments

15.2. The Council's investment priorities are the security of capital and the liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

15.3. The Council are asked to approve the Investment Strategy set out in Appendix 2.

16. Minimum Revenue Provision (MRP) Statement

16.1 In accordance with Statutory Instrument 2008 number 414 and guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual MRP needs to be approved before the start of the financial year. Following a review of the previous MRP policy, it is proposed to amend the calculation basis for supported borrowing from 2016/17. This will generate a saving of £3.8m in 2016/17, compared to the previous calculation basis. It is proposed to take £2.8m of this as a base budget revenue saving in 2016/17 and retain £1m within the MRP budget to help fund any potential shortfall of capital receipts and allow for any investment in significant projects in the future. Full details of the revised calculation method are included in Appendix 3 and Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 3.

17. Leasing

17.1. In the past the Council has used operating leases to finance the purchase of vehicles and equipment. The Section 151 Officer will assess the relative merits of operating and finance leases on a case by case basis and enter into the most advantageous. Schools I.T equipment will continue to be internally financed by borrowing against a small fund set against school balances with schools repaying their borrowing over a period of 3 years.

18. Lending to Housing Associations

18.1. As previously approved by full Council, the Council has offered to lend funds to Shropshire Housing Ltd (which incorporates South Shropshire Housing Association and the Meres & Mosses Housing Association) and Severnside Housing at an agreed rate. In the current climate Housing Associations can find it difficult to obtain funding for new affordable housing and the Council is generating only a small amount of interest on revenue balances.

18.2. It has been agreed that the interest rate charged will depend on the period over which the loan is to be taken and that it will be linked to the applicable PWLB rate plus an administration fee. It has been agreed to offer to lend up to £10 million to each of these Housing Associations in order to support the building of affordable housing and shared office accommodation in Shropshire. For security purposes, each loan will be secured against existing assets held by or owned by the Housing Association. If Shropshire Rural were to request a similar facility, for a smaller amount given the size of this local Housing Association, this could also be facilitated.

18.3. Officers have sought advice from Wragge & Co who have confirmed that the Council has the power to lend funds to Housing Associations under the Housing Act 1996 and have drawn up the legal documentation relating to the loan agreement. To date £9,770,000 has been drawn down by Shropshire Housing Ltd and £2,280,000 by Severnside Housing. Severnside Housing are looking to draw down their remaining outstanding balance by 31 March 2016.

19. Housing ALMO

19.1 On 22 November 2012 Council gave approval for transfer of the management of the Council's housing stock to an Arm's Length Management Organisation (ALMO) from April 2013. Shropshire Towns and Rural Housing Limited is a company limited by guarantee wholly owned by the Council that has been set up specifically for this purpose. Under this arrangement all assets and liabilities of the Housing Revenue Account (HRA), including the housing stock and the self-financing debt, remain with the Council, but day to day management of the service and the HRA will be undertaken by the ALMO under the terms of a management agreement.

19.2 The new company has set up a separate bank account and this will initially be under the umbrella of the current Council arrangements which will enable any surplus funds will be invested by Shropshire Council Treasury Management Team. The Capital programme and debt management of the HRA will be subject to joint agreement between The Council and the ALMO.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Treasury Management Practices

Treasury Strategy 2015/16 (Council 26 February 2015)

Treasury Strategy 2015/16 Mid-Year Review (Council 17 December 2015)

Capital Strategy Report 2016/17 to 2019/20 (Cabinet 10 February 2016)

Proposal for Future Management of Council Housing (Council 22 November 2012, Item 10)

Cabinet Member : Malcolm Pate, Leader of the Council

Local Member

N/A

Appendices:

1 – Prudential Indicators

2 – Council's Annual Investment Strategy

3 – Minimum Revenue Provision Policy Statement