Wards affected: General

Strategy Group – 13th February 2014

Treasury Management Strategy Statement and Annual Investment Strategy 2014/2015

Resources Issues

1. Purpose of Report

1.1 To advise Strategy Group of the expected activities and appropriate operational parameters of the treasury management function in 2014/2015. To endorse the "Treasury Management Strategy Statement and Annual Investment Strategy 2014/2015"

2. Advice

That it be RECOMMENDED:	That the Council's Treasury Management Strategy Statement and Annual Investment Strategy 2014/2015 be approved.

3. Introduction

3.1 The Council is required to set a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that the cash flow is adequately planned, with cash being available when needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. 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. The management of longer term cash flow may involve arranging long or short term loans, using longer term cash flow surpluses. This authority however is currently debt free and as reported in the medium term financial plan there are no plans to change the status of the authority.

Treasury management is defined as :

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

3.2 Reporting Requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. Strategy Group undertakes this role.

Prudential and Treasury Indicators and Treasury Strategy (This Report) – The first and most important report covers:

- the capital plans (including prudential indicators);
- the Treasury Management Strategy (how the investments and borrowings are organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are managed).

A Mid-Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the objectives or whether any policies need revision.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3.3 Treasury Management Consultants

The Council uses Capita Asset Services (formerly Sector) 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.

3.4 Treasury Management Strategy 2014/2015

The 2014/15 strategy covers two main areas:

Capital Issues

- the capital plans and prudential indicators.

Treasury Management Issues

- treasury limits for 2014/15 to 2016/17;
- prudential and treasury indicators 2014/15 to 2016/17 which will limit the treasury risk and activities of the Council;
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy and Minimum Revenue Provision (MRP) Policy Statement;
- the annual investment strategy;
- creditworthiness policy;
- Icelandic Investments.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

4. The Capital Plans Prudential Indicators

The Council's capital expenditure plans are the key driver of treasury management activity.

The table below summarises the above capital expenditure and how it is being financed by capital or revenue resources. Any shortfall of resources could result in a borrowing need.

Capital expenditure £m	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Total Capital Expenditure	11,757	7,278	11,756	4,481
Financed by:				
External Funding	3,954	737	188	273
Capital reserves	7,803	6,541	11,568	4,208
Revenue	0	0	0	0
Net financing need for the year	11,757	7,278	11,756	4,481

The table below shows the Capital Prudential Indicators :-

Capital Prudential Indicators	**2013/14**	**2014/15**	**2015/16**	**2016/17**
(1) Extract From Budget Report	**£'000**	**£'000**	**£'000**	**£'000**
	Probable outturn	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure	11,757	7,278	11,756	4,481
Ratio of financing costs to net revenue stream	-1.69%	-1.61%	-1.66%	-1.68%
Net Borrowing Requirement				
Brought forward 1 April	-67	-67	-67	-67
Carried forward 31 March	0	0	0	0
In year borrowing Requirement	-67	-67	-67	-67
Capital Financing Requirement as at 31 March	-67	-67	-67	-67
Annual change in Cap. Financing Requirement	0	0	0	0
Incremental impact of capital investment decisions				
Increase/Decrease in council tax (band D) per annum	-£0.40	-£0.61	-£0.60	-£0.60

5. Treasury Limits for 2014/2015 to 2016/2017

5.1 It is a statutory duty 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 in England and Wales, as the Authorised Borrowing Limit and represents the legislative limit specified in the Act.

5.2 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 level is 'acceptable'.

5.3 Whilst termed an "Authorised Borrowing Limit", the capital plans can be financed 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.

6. Prudential and Treasury Indicators 2014/15 – 2016/17

Treasury Indicators	2013/14	2014/15	2015/16	2016/17
	£'000	£'000	£'000	£'000
	Outturn	Estimate	Estimate	Estimate
Authorised Limit for External Debt -				
Borrowing	6,000	6,000	6,000	6,000
Other long term liabilities	0	0	0	0
TOTAL	6,000	6,000	6,000	6,000
Operational Boundary for external debt				
Borrowing	3,000	3,000	3,000	3,000
Other long term liabilities	0	0	0	0
TOTAL	3,000	3,000	3,000	3,000
Upper limit for fixed interest rate exposure				
Net interest re fixed rate borrowing/investments	100%	100%	100%	100%
Upper limit for variable rate exposure				
Net interest re variable rate borrowing	0%	0%	0%	0%
Net interest re variable rate investments	30%	30%	30%	30%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£15m	£15m	£15m	£15m

Maturity structure of fixed rate borrowing during 2014/2015 (if required)	upper limit %	lower limit %
under 12 months	100	0
12 months and within 24 months	100	0
24 months and within 5 years	100	0
5 years and within 10 years	100	0
10 years and above	100	0

7. Current Treasury Position

The Council's Treasury portfolio as 31/01/2014 comprised:-

Counterparty	Amount (£)	Maturity	Rate %
Nationwide B Soc	5,000,000	07/02/2014	0.45
Barclays Bank	3,000,000	20/03/2014	0.40
Santander UK	5,000,000	22/05/3025	0.55
Lloyds TSB Bank	5,000,000	11/04/2014	1.10
Bank of Scotland	3,000,000	07/05/2014	1.05
Standard Chartered	5,000,000	16/07/2014	0.53
Ulster Bank	5,000,000	27/10/2014	0.85
Bank of Scotland	2,000,000	13/01/2015	0.95
TOTAL	33,000,000		

The investments quoted in the table above do not include those investments frozen in Icelandic banks see Section 11 of this report.

The average interest rate achieved as at the 31st January 2014 for all investments is 0.67%.

8. Prospects for Interest Rates

Capita Asset Services as part of their service assist the Council to formulate a view on interest rates. The following table gives their central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
March 2014	0.50	2.50	4.40	4.40
June 2014	0.50	2.60	4.50	4.50
Sept 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
March 2015	0.50	2.80	4.60	4.70
June 2015	0.50	2.80	4.70	4.80
Sept 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
March 2016	0.50	3.10	5.00	5.10
June 2016	0.75	3.20	5.10	5.20
Sept 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
March 2017	1.25	3.40	5.10	5.20

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established.

9. Borrowing Strategy and the Minimum Revenue Provision (MRP) Policy Statement

Borrowing Strategy

It is anticipated that there will be no capital borrowings required during 2014/2015. The short-term strategy for potential cash flow issues is in line with the limits set.

Minimum Revenue Provision Strategy

At present the Council does not have a Minimum Revenue Provision as we are a debt free authority and it is anticipated that this situation will not change in 2014/2015. If however we should have a requirement for borrowing we would endeavor to assess all the available methods for calculation of the provision and accordingly report this to the appropriate committee.

10. Annual Investment Strategy

10.1 Investment Policy

The Council's investment policy has 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 will be security first, liquidity second and then return.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Capita ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors (Capita Asset Services) in producing its colour codings which show the varying degrees of creditworthiness.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories.

Specified Investments: All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum high rating criteria where applicable.

	Minimum 'High' Credit Criteria	Use
Debt Management Account Deposit Facility	---	In-house
Term Deposits – Other Local Authorities	---	In-house
UK Nationalised and Semi Nationalised Banks	Semi Nationalised	In-house
Term Deposits – Bank and Building Societies	Sovereignty: AAA* Short Term: F1 Long-term: A, Viability a	In-house and Fund Managers
Certificates of deposits issued by banks building societies covered by UK government	Sovereignty AAA* Short-term: F1, Long-term: A, Viability a	In-house buy and hold and fund managers
UK Government Gilts	Sovereignty Rating AAA*	In-house and fund managers
Treasury Bills	Sovereignty Rating AAA*	In-house and fund managers
Money Market Funds	AAA	In-house and fund managers

Non-Specified Investments: A maximum of 60% or £30m, whichever is the lower of the total portfolio, will be held in aggregate in non-specified investment (i.e. over 1 year)

	Minimum Credit Criteria	Use	Max. maturity period
Term deposits – local authorities	--	In-house	5 Years
UK Nationalised and Semi Nationalised Banks	Semi Nationalised	In – House	5 Years
Term deposits – banks and building societies	Sovereignty: AAA* Short-term: F1+, Long-term: AA-, Viability a	In-house	5 Years
Certificates of deposits issued by banks and building societies	Sovereignty: AAA* Short-term: F1+, Long-term: AA-, Viability a	In house and Fund managers	2 Years
UK Government Gilts	Sovereignty Rating AAA*	In house and Fund Managers	5 Years
Bonds issued by multilateral development banks	Sovereignty Rating AAA *	In-house and fund managers	5 Years
Sovereign bond issues (i.e. other than the UK govt)	Sovereignty Rating AAA *	In house and Fund Managers	5 Years

* For both specified and non-specified investments the UK is an exception to the stated criteria in that we will continue to deal with UK institutions in the event of a downgrading in the UK sovereign rate.

10.2 Creditworthiness Policy

This 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 Council criteria are set on the Fitch credit rating and in the absence of this Moody's ratings will be taken. However, it does not rely solely on the current credit ratings of counterparties but also uses the following overlays:-

- credit watches and credit outlooks from credit rating agencies;
- 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 Credit Default Swaps (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. The Council will therefore use counterparties within the following durational bands:-

- Yellow 5 years
- Dark Pink 5 years for Enhanced money market funds with a credit score of 1.25
- Light Pink 5 years for Enhanced money market funds 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

This Council will use the approach suggested by CIPFA in the 2011 Code of using all ratings from all three rating agencies to determine creditworthy counterparties. The Capita Asset Services creditworthiness service uses ratings from all three agencies, and by using a scoring system does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored as and when there is a notification and also checked on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services creditworthiness service.

- 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.

- If a body is placed on negative rating watch with Fitch or Moody's in the absence of a Fitch rating (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near the floor of the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body. Alternatively if the result of a negative rating watch keeps the counterparty within the credit ratings set out by the Council, the counterparty can be considered for investment.
- The Council uses Fitch ratings to derive its counterparty criteria. Where counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. All credit ratings will be monitored daily.
- The Council is alerted to changes in Fitch ratings through its use of the Capita Asset Services credit worthiness service. Subsequently,
- Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

10.3 Country Limits

With the exception of the UK, the Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them).

10.4 Current Investment situation

At the present time as advised by the Section 151 Officer, all current investments are being made with the Government's Debt Management Office in their Debt Management Account Deposit Facility (DMADF), other Local Authorities, Banks and Building Societies in UK that meet the criteria set by the Council and all Nationalised and Semi Nationalised Banks. Investments can also be made in Treasury Bills, Money Market Funds and Certificates of Deposits. The risk averse tightening of investment counterparties was a measure against the economic downturn and the resulting uncertainty. It is now timely to review this approach and the Section 151 Officer from 1st April 2014 will amend the treasury practices to incorporate the full list of available counterparties on the lending list. Since the financial crisis in 2008 a number of processes have changed to ensure the robustness of investment decisions. These processes are now well embedded and improved and give confidence that by utilising the full list of counterparties the authority will still be operating within very tight and strict limits.

10.5 Investment returns expectations

Capita Asset Services forecast for Bank Rate is to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

10.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

11. OTHER ISSUES

11.1 Icelandic Bank Investments

The progress on recovery of investments in Icelandic banks is as follows :-

Counterparty	Original Amount Invested	Actual Recovered £m	Expected Recovery of Claim Amount (inc Interest) £m	Expected Recovery %
Landsbanki Islands	£3,000,000	1.671	3.219	100
Glitnir Bank	£2,000,000	2.121	2.121	100
Kaupthing Singer & Friedlander	£2,000,000	1.664	1.741	85.25
Heritable	£1,000,000	0.956	0.956	95.6
TOTAL	£8,000,000	6.412	8.037	95.5

11.2 In relation to Heritable Bank advice from CIPFA suggests that there will be no further dividends to be received that may be considered material therefore the total repayment remains at 94% which is above the expected amount of 88%.

11.3 Kaupthing Singer & Friedlander (KSF), on the 20th December 2013 repaid 2.5% of our claim totalling 81.5% of the expected claim in the range of 85% to 86.5% as reported in the Administrators Progress Report. However the Administrators stress that the estimate could be higher or lower as there are significant issues which may impact on future repayments, and therefore the estimate is indicative and cannot be relied on. This Council took the prudent view at the end of the last financial year and are budgeting for an 85.25% repayment in line with CIPFA LAAP Bulletin.

11.4 Landsbanki has to date made a repayment of 52% of an expected 100% with the next dividend repayment expected to be in December 2014. CIPFA estimates that full repayment is still expected but could take up to December 2019 to complete.

11.5 All Glitnir claims have now been settled.

12. Implications

12.1 Financial – This report is wholly concerned with financial issues.

12.2 Personnel - None, other than those mentioned in the report above.

12.3 Legal/Constitutional – No implications.

12.4 Environmental – No implications.

12.5 Policy – No implications.

12.6 ICT – No implications.

12.7 Crime and Disorder – No implications.

12.8 Human Rights – No implications.

12.9 Equalities – No implications.

13. Conclusions

13.1 The economy continues to show very real, if fragile, signs of recovery and if appropriate the section 151 officer will not hesitate to restrict investments, in line with the approved strategy, should there be a need to. Returns on investments will continue at a very low level for the foreseeable future with security being the overriding factor.

Audra Statham
Chief Financial Officer

Background papers:
CIPFA Treasury Management Code of Practice 2011 (the Code)
Previous minutes:

SG.15/04/01 Treasury Management Strategy Statement and Annual Investment Strategy 2013/2014

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