Report Reference: SG.120215/8

Wards affected:

General

Strategy Group – 12th February 2015

Treasury Management Strategy Statement and Annual Investment Strategy 2015/2016

Resources Issues

1. Purpose of Report

To advise Strategy Group of the expected activities and appropriate operational parameters of the treasury management function in 2015/2016. To endorse the "Treasury Management Strategy Statement and Annual Investment Strategy 2015/2016"

2. Advice

That it be RECOMMENDED:	That the Council's Treasury Management Strategy Statement and Annual Investment Strategy 2015/2016 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.

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.

Treasury Management Strategy Statement and Annual Investment Strategy (This Report) – The first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- 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 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.

The Council recently underwent a procurement exercise which we were part of a framework which included other local authorties, lead by Northamptonshire County Council, to which was resolved that we continue to use with Capita Asset Services.

3.4 Treasury Management Strategy 2015/2016

The 2015/16 strategy covers two main areas:

Capital Issues

- the capital plans and prudential indicators;
- the minimum revenue provision (MRP) policy;
- core funds and expected investment balances;
- affordability prudential indicators.

Treasury Management Issues

- the current treasury portfolio;
- treasury indicators for 2015/16 to 2017/18;
- prospects for interest rates;
- the Borrowing Strategy;
- policy on borrowing in advance of need;
- the investment strategy;
- creditworthiness policy;
- policy on use of external service providers.

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. Capital Issues

4.1 The Capital Plans Prudential Indicators

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

The indicator below summarises the 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	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total Capital Expenditure	4,293	11,223	6,754	4,174
Financed by:				
External Funding	433	405	205	156
Capital reserves	3,739	10,818	2,549	4,016
Revenue	121	0	4,000	0
Net financing need for the year (CFR)	0	0	0	0

The Council's borrowing need (the Capital Financing Requirement)

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

The Council under the current and approved Medium Term Financial Plan have no plans to borrow and therefore has a zero CFR.

4.2 Minimum Revenue Provision (MRP) Policy Statement

If the Council was to borrow it would be required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision MRP), although it is allowed to undertake additional voluntary payment if required (Voluntary Revenue Provision VRP).

CLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement.

From 1 April 2015 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be either*:*

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);

- **Depreciation method** – MRP will follow standard depreciation accounting procedures;

These options provide for a reduction in the borrowing need over approximately the asset's life.

4.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Fund balances / reserves	15.133	15.895	13.834	13.568
Capital reserves	13.296	6.682	0.474	0.558
Total core funds	**28.429**	**22.577**	**14.308**	**14.126**
Working capital	**-2.841**	**-2.841**	**-2.841**	**-2.841**
Expected investments	**25.588**	**19.736**	**11.467**	**11.285**

4.4 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

4.4.1 Ratio of financing costs to revenue streams

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. In other words in 2013/14 the interest earnings were approximately 4.01% of our net revenue spend.

%	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio	-4.01	-1.61	-1.94	-1.93	-1.97

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

4.4.2 Incremental impact of capital investment decisions on council tax

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

£	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Council tax - band D	-0.22	-0.54	-1.33	-2.34	-2.97

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5.0 Treasury Management Issues

5.1 Current Treasury Portfolio

The Council's Treasury portfolio as 31/01/2015 comprised:-

Counterparty	Amount (£)	Maturity	Rate %
Svenska Handelsbanken	3,000,000	13/02/2015	0.40
Svenska Handelsbanken	2,000,000	13/03/2015	0.40
Lloyds Bank	5,000,000	10/04/2015	0.95
Bank of Scotland	3,000,000	07/05/2015	0.95
Barclays Bank	5,000,000	02/07/2015	0.64
Nationwide B Soc	5,000,000	07/07/2015	0.66
Standard Chartered	5,000,000	16/07/2015	0.66
Santander UK	5,000,000	28/07/2015	0.70
Royal Bank of Scotland	5,000,000	27/10/2015	0.89
TOTAL			

The Council has not previously had to borrow from external funding and does not plan to during the life of the current Medium Term Financial Plan. If borrowing was required in future this position would change and before external borrowing was considered the Council's own cash reserves would be utilised to keep costs to minimum. This would result in reserves not being 'cash backed' and if the reserves were needed external borrowing would take place.

5.2 Treasury Indicators for 2015/16 – 2017/18

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. Whilst the council has no plans to borrow an operational boundary is set for occasions where very short term bowing is required for cash flow purposes only.

Operational boundary £m	**2014/15 Actual**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Debt	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

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

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

Authorised limit £m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	6.000	5.000	5.000	5.000
Other long term liabilities	0	0	0	0
Total	6.000	5.000	5.000	5.000

6. 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 view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2014	0.50	2.50	3.90	3.90
Mar 2015	0.50	2.70	4.00	4.00
Jun 2015	0.75	2.70	4.10	4.10
Sep 2015	0.75	2.80	4.30	4.30
Dec 2015	1.00	2.90	4.40	4.40
Mar 2016	1.00	3.00	4.50	4.50
Jun 2016	1.25	3.10	4.60	4.60
Sep 2016	1.25	3.20	4.70	4.70
Dec 2016	1.50	3.30	4.70	4.70
Mar 2017	1.50	3.40	4.80	4.80
Jun 2017	1.75	3.50	4.80	4.80
Sep 2017	2.00	3.50	4.90	4.90
Dec 2017	2.25	3.50	4.90	4.90
Mar 2018	2.50	3.50	5.00	5.00

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 and especially during 2014, 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 2015, particularly in the services and construction sectors. However, growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone. There does need to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this initial stage in the recovery to become more firmly established.

7. Borrowing Strategy

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

Policy on Borrowing in Advance of Need

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 considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

8. Annual Investment Strategy

8.1 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 the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

As a result of rating agency changes, as reported to Strategy Group in the Treasury Management Strategy Statement and Annual Investment Statement Mid-year Report on the 20th November 2014, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This change does not reflect deterioration in the credit environment but rather a change of method in repsonse to regulatory changes.

As with previous practice, ratings will 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.

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,	In-house and Fund Managers
Certificates of deposits issued by banks building	Sovereignty AAA* Short-term: F1, Long-term: A,	In-house, custodians and fund managers

societies covered by UK government		
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-,	In-house	5 Years
Certificates of deposits issued by banks and building societies	Sovereignty: AAA* Short-term: F1+, Long-term: AA-,	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.

8.3 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.

8.4 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).

8.5 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 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. Processes in Treasury Management 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.

8.6 Investment returns expectations

Capita Asset Services forecast for Bank Rate is to remain unchanged at 0.5% before starting to rise from December 2015. Bank Rate forecasts for financial year ends (March) are:

- 2014/15 0.50%
- 2015/16 0.75%
- 2016/17 1.25%
- 2017/18 2.00%

8.7 Treasury Management Practices

The Council's Treasury Management Practices (TMP's) set out the manner in which the Council will seek to achieve its treasury management policies and objectives, and how it will manage and control those activities.

The Council's TMP's schedules cover the detail of how the Council will apply the TMP Main Principles in carrying out its operational treasury activities. They are reviewed annually and approved by the Council's Chief Financial Officer.

8.8 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.

9. Implications

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

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

9.3 Legal/Constitutional – No implications.

9.4 Environmental – No implications.

9.5 Policy – No implications.

9.6 ICT – No implications.

9.7 Crime and Disorder – No implications.

9.8 Human Rights – No implications.

9.9 Equalities – No implications.

10. Conclusion

10.1 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:

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