**TREASURY MANAGEMENT STRATEGY STATEMENT,
MINIMUM REVENUE PROVISION POLICY STATEMENT AND
ANNUAL INVESTMENT STRATEGY 2014/15**

EXECUTIVE MEMBER: Cllr Gillian Troughton
LEAD OFFICER: Darienne Law, Head of Corporate Resources
REPORT AUTHORS: Leanne Barwise, Senior Accounting Officer

This report is being presented for scrutiny, prior to being considered by Special Executive on 13 February 2013 and finally to Full Council for approval on 27 February 2013.

RECOMMENDATION:

It is asked that Audit & Governance Committee scrutinise the Treasury Management Strategy Statement, the Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2014/15 contained within this report.

1. INTRODUCTION

1.1 Background

The Council is required to operate 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 this cash flow is adequately planned, with cash being available when it is 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 any borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash could involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Copeland's Portfolio and Investment Strategy

Copeland Borough Council holds an average investment portfolio of £20-25m of its own funds (reducing as used) and in April 2013 received an upfront NNDR receipt of £31m in place of the usual 12 monthly instalments. It is anticipated that this will also happen in April 2014. Our portfolio would then be in the region of £54m, reducing throughout the year as the NNDR receipt is required to be paid back to DCLG on a monthly basis.

The main principal governing the Councils investment criteria is the security of its investments although yield (or return) is also considered. Our counterparty list is derived from the minimum credit ratings that are agreed as outlined within this strategy document and approved at Council. This list ultimately limits us to use the counterparties for investment that are above the minimum criteria that we set (as detailed in paragraph 4.7). Should the criteria be set too low then the Authority would be open to risk. If set too high it could make it difficult to place our funds. The TMSS sets out the overall policy parameters,, however officers currently tighten the operational criteria further to protect the Authority's funds in the current economic climate.

Some institutions on our counterparty list are available but not currently being used by the Authority. For instance, we choose not to place investments with any non-UK Banks even though they meet our minimum criteria. This is mainly due to the current state of the economy outside of the UK but remain on our list to provide flexibility should the position change in the future. Other counterparties (who we would be willing to deal with) will only deal with customers with much bigger portfolios than ours i.e. HSBC, however as they meet the minimum criteria they are included.

Wherever possible we maximise interest on fixed term investments with the part-nationalised banks by securing investments (achieved rates this year of 0.80% and 1.05%) for as long a period as possible and up to the maximum limits (up to £7.5m each) set out in 2013/14 strategy. Unfortunately, the result of this is that other enhanced rates offered by the part nationalised banks are unable to be secured and so the majority of our portfolio is held in AAA Money Market Funds. These are highly secure*, liquid institutions but the yield is much lower (ranging from 0.30% to 0.39%). This, in turn reduces our average interest rate achieved. We continue to achieve a rate above the 7 Day LIBID (London Interbank Bid Rate – the rate in which banks bid to borrow) as a benchmark.

This strategy contains a number of changes from the previous year's strategy document. These are:-

- Increasing the limits on both fixed and variable rate investments to the value of our maximum portfolio at £54m. This will mean that we are not restricted to a definite level of fixed or variable rate investments so we can achieve the best rates available (paragraph 3.5, Page 13).
- Increasing the limit on the part-nationalised banks from £7.5m (with an additional £2.5m with the prior approval of the s151 Officer to give an ultimate limit of £10m) to £10m. This will allow us to take advantage of current enhanced liquid rates (Table at 4.7, Page 17).
- Reducing our Financial Strength/Viability rating down from a C to a C- which will allow investments with two further counterparties. Risk will be mitigated by limiting investments with these two counterparties to 100 days (paragraph 4.7, Pages 15 & 16).
- The introduction of Enhanced Money Market Funds. These are slightly longer dated money market funds which should allow some increased yield at low risk. Officers will investigate these options in conjunction with our advisers. Overall investment amounts will be limited.

Members should note that the limits that are presented throughout this report have been discussed with our Treasury Consultants, Capita Asset Services, and are deemed acceptable for the Authorities risk appetite which is very low.

*See paragraph 4.6 where the security of MMF's is explained in more detail.

Treasury Management Policy Statement

CIPFA defines treasury management 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."*

1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury 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 to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This annual report was presented to Executive on 19 November 2013 updating members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision. In addition, this Council will receive quarterly update reports.

An annual treasury report – This report (also known as the Treasury management Outturn Report)provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit and Governance Committee and the reason for presentation today.

1.3 Treasury Management Strategy for 2014/15

The strategy for 2014/15 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- 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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. Treasury Management training was provided prior to the Audit and Governance Committee meeting in February 2013 and further training was arranged prior to Audit and Governance Committee at 30 January 2014.

The training needs of treasury management officers are reviewed periodically.

1.5 Treasury management consultants

The Council uses Capita Asset Services Treasury Solutions (formerly known as 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.

2. THE CAPITAL PRUDENTIAL INDICATORS 2014/15 – 2016/17

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts, the details of which are elsewhere on the Executive agenda for consideration:

Capital expenditure £000's	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Total	1,435	1,441	1,340	600	600

The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

The following table summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources.

Capital expenditure £000's	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Total	1,435	1,441	1,340	600	600
Financed by:					
Capital receipts	982	884	1,079	339	339
Capital grants	446	557	261	261	261
Revenue	7	-	-	-	-
Net financing need for the year	**-**	**-**	**-**	**-**	**-**

2.2 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 total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital 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. Copeland currently finances all its capital expenditure immediately through capital receipts/grants and as a consequence the CFRis not increasing..

The CFR is required to be paid off over time. This charge is called the minimum revenue provision (MRP) and is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. As at the beginning of the financial year 2013/14 the Council had £6.4m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£000's	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Capital Financing Requirement					
Total CFR	8,465	7,911	7,379	6,962	6,556
Movement in CFR	-	(554)	(532)	(417)	(406)

Movement in CFR represented by					
Net financing need for the year (above)	-	-	-	-	-
Less MRP and other financing movements	-	(554)	(532)	(417)	(406)
Movement in CFR	-	(554)	(532)	(417)	(406)

2.3 Minimum revenue provision (MRP) policy statement

The Council is 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 also allowed to undertake additional voluntary revenue payments (VRP) if required but this Council does not.

CLG regulations have been issued which require 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:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1); *or*

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **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) (option 3); *and*
- **Depreciation method –** MRP will follow standard depreciation accounting procedures (option 4);

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

Repayments of PFI or Finance Leases are allowable to use as a proxy for the above methods. The reduction in the CFR in 2.3 above is as a result of the PFI and finance lease MRP.

2.4 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 on-going 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 £000's	**2012/13 Actual**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**
Fund balances / reserves	3,216	2,933	2,795	2,795	2,795
Capital receipts	3,367	2,391	1,664	2,492	3,724
Earmarked Reserves	6,172	4,625	4,352	4,385	4,384
Provisions	311	311	311	311	311
Total core funds	**13,066**	**10,261**	**9,122**	**9,983**	**11,214**
Working capital*	1,423	1,423	1,423	1,423	1,423
Under/over borrowing	3,984	2,915	2,915	2,915	2,915
Expected investments	**18,473**	**14,599**	**13,460**	**14,321**	**15,552**

*Working capital balances shown are estimated year end; these may be higher mid-year

2.5 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. The Council is asked to approve the following indicators:

2.6 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Ratio	7.16	7.73	7.42	6.61	5.99

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

2.7 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 (presented elsewhere on the agenda) 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.

Revenue costs include depreciation charges (or substitued MRP payments), additional maintenance and running costs (above the current level already within revenue budgets), reduced running costs or costs which can be offset against income generated. The current capital programme doesn't include any additional costs over the current net budget provision as can be shown in the next table:

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

£	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Council tax - band D	0	0	0	0	0

3. Borrowing

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2013, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting an over borrowing position.

£000's	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
External Debt					
Debt at 1 April	5,000	5,000	5,000	5,000	5,000
Expected change in Debt	0	0	0	0	0
Other long-term liabilities (OLTL)	6,380	5,826	5,294	4,877	4,471
Expected change in OLTL	-	(554)	(532)	(417)	(406)
Actual gross debt at 31 March	**11,380**	**10,826**	**10,294**	**9,877**	**9,471**
The Capital Financing Requirement	**8,465**	**7,911**	**7,379**	**6,962**	**6,556**
Under / (over) borrowing	**2,915**	**2,915**	**2,915**	**2,915**	**2,915**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt 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 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Corporate Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt. It is to be used solely as a guideline figure.

Operational boundary £000's	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	7,000	7,000	7,000	7,000
Total	**12,000**	**12,000**	**12,000**	**12,000**

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 (no change from current year):

Authorised limit £000's	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**
Debt	9,000	9,000	9,000	9,000
Other long term liabilities	8,000	8,000	8,000	8,000
Total	**17,000**	**17,000**	**17,000**	**17,000**

3.3 Prospects for Interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view on bank base rate forecast which drives investment returns and borrowing rate forecasts.

Annual Average %	**Bank Rate %**	**PWLB Borrowing Rates % (including certainty rate adjustment)**		
		5 year	**25 year**	**50 year**
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.40	4.40
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.50	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.20	5.00	5.10
Jun 2016	0.50	3.30	5.10	5.20
Sep 2016	0.75	3.50	5.10	5.20
Dec 2016	1.00	3.60	5.10	5.20
Mar 2017	1.25	3.70	5.20	5.30

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. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have improved this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Investment retruns are likely to remian relatively low during 2014/15 and beyond;

- Concerns have subsided considerably in 2013 for the Eurozone. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3.3 Single Investment Transaction Limit

In the previous Treasury Management Strategy Statement every investment transation was subject to an operational single transaction limit of £5m per counterparty. However, upon the receipt of a substantial NNDR receipt it proved difficult to adhere to this limit when investing the receipt with Government (which we can invest an unlimited amount). The £5m limit has therefore been removed from the strategy this year in anticipation of another substantial NNDR receipt. The removal of such limit will mean the maximum investment limit per counterparty set out throughout this strategy may be utilised. Please see table at the end of section 4.7 for monetary and time limits per type of institution.

3.4 Borrowing strategy

The Council's debt portfolio contains one remaining Market Loan of £5 million which will mature on 1st February 2042. The rate is fixed at 7.55% and we repay a total of £377,500 a year. We continually assess the position of this loan with our Treasury Consultants, Capita Asset Services, to see whether we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form, as the penalty for repaying early would be prohibitive as it is currently estimated at £3m (on top of the £5m debt repayment).

Although, at this time it is not anticipated any further borrowing will be necessary, in the unlikely event of a need to borrow, the Section 151 Officer under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

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;
- Upper limits on fixed interest rates on investments. This identifies a maximum limit for fixed rate investments.
- Upper limits on variable rates on investments. As previous, this identifies a maximum limit for variable interest rate investments.
- 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.

The Council is asked to approve the following treasury indicators and limits:

£000's	2014/15	2015/16	2016/17
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	5,100	5,100	5,100
Limits on variable interest rates based on net debt	5,100	5,100	5,100
Limits on fixed interest rates: • ***Debt only*** • ***Investments only***	 *5,100* *54,000*	 *5,100* *54,000*	 *5,100* *54,000*
Limits on variable interest rates • ***Debt only*** • ***Investments only***	 *5,100* *54,000*	 *5,100* *54,000*	 *5,100* *54,000*
Maturity structure of fixed interest rate borrowing 2014/15			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%

3.6 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Any associated risks will be approved and reported through the standard reporting method.

3.7 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, at this moment the cost of repaying our £5m debt is prohibitive.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual 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 paid on current debt.

All rescheduling decision made by the Section 151 Officer and will be reported to the Council, at the earliest meeting following its action.

4 ANNUAL INVESTMENT STRATEGY

4.6 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 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, then return.

In accordance with the above 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 these reflect in the eyes of each agengy. Using our 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.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

In recent times our risks have increased, even though our counterparty criteria and limits remain unchanged. The 2008 banking crisis highlighted risks within the banking industry, which regulatory authorities are seeking to address. Money Market Funds, highly rated investment vehicles, will need to change the way in which they operate in order to meet the new requirements whilst also meeting client expectations. Funds which currently operate on a Stable Net Asset Value (SNAV -their objective is to ensure that £1 invested will be returned), may find it advantageous to move to a Variable Net Asset Value in the future (VNAV - whereby the principal amount invested can potentially vary higher or lower than the amount invested), whilst maintaining the same operational criteria. This option should allow similar security and better returns in the future than would otherwise be available. Money Market Funds remain one of the safest counterparties and our credit base criteria remains unchanged, albeit it will now allow the use of variable Net Asset Value Funds. For the funds being used risk is expected to remain unchanged, but Members should be aware of this change that is out of the control of the Authority. As this area develops and more is known about the impact of the regulatory changes Members will be informed through the regular treasury reports.

Investment instruments identified for use in the financial year are listed in Appendix 3 under the 'Specified' Investments (ie investments with maturities of upto a maximum of one year meeting the high quality criteria) and 'Non-Specified' investment categories (ie all other investments that do not meet the Specified criteria). Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.7 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Section 151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Council will only use banks which:
    1. are UK banks; or
    2. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA

  and have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

    1. Short term – *F1*
    2. Long term – *A-*
    3. Viability / financial strength – *C-* (Fitch / Moody's only)
    4. Support – *4* (Fitch only)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Money market funds – AAA
- Enhanced money market funds (EMMFs)*
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions

*Enhanced MMFs are similar to the current MMFs and should allow marginally higher returns. These funds invest slightly longer than the current liquid MMFs and access to monies is usually over a 1 or 2 day notice period, rather than immediately. Officers will consult with our advisers over their introduction.

A limit of 50% of the whole portfolio will be applied to the use of non-specified investments.

This Council also applies the creditworthiness service provided by Capita Asset Services. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments and the use of this method exceeds the approach suggested by CIPFA.

Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:

- no more than 50% of the whole portfolio will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

Sector Limits	Fitch Long term Rating (or equivalent)	Money and/or % Limit	Time Limit
Banks 1 higher quality	***AA-***	**£5m**	**3yrs**
Banks 1 medium quality	***A-***	**£3m**	**1yr**
Banks 2 – part nationalised	**-**	**£10m**	**1yr**
Limit 3 category – Council's banker (not meeting Banks 1)	**-**	**£10k**	**1 day**
Other institutions limit	**-**	**£2m**	**1yr**
DMADF	**AAA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£5m**	**1yr**
Money market funds (SNAV and VNAV)	**AAA**	**£5m**	**liquid**
Enhanced money market funds	**AAA**	**5 / 10%**	**liquid**

The proposed criteria for specified and non-specified investments are shown in Appendix 3 for approval.

In an exceptional circumstance beyond our control in April 2013, the monetary limit in the part-nationalised banks (Banks 2) in the table above was temporarily breached for 1 day. The strategy breach was related to a substantial NNDR receipt being credited to our account after the money markets had closed for daily dealing. With no alternative we placed the funds within our own bank in a Special Interest Bearing Account (which is a higher rated account with the same security) overnight until it could then be invested the following day. This action subsequently resulted in an overnight breach of our self-imposed monetary limits for investments with a part nationalised bank which is restricted within the Treasury Management Strategy Statement to £7.5m. The Section 151 Officer authorised this action. The funds were then invested as originally intended the following day. We will try to endeavour that any future substantial receipts of this nature are cleared prior to the 1pm dealing deadlines, wherever possible.

4.8 Country limits

The Council has determined that it will only use approved counterparties from countries (excluding the UK) with a minimum sovereign credit rating of *AAA* from Fitch. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.9 Investment strategy

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

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 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%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

Capita's suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

2014/15	0.50%
2015/16	0.50%
2016/17	0.75%
2017/18	2.25%

It should be noted however the above rates are probably unachievable for us as an Authority over the whole portfolio. The current average rate we achieve is below this at 0.44%. This is because we need to use AAA Money Market Funds for the majority of our portfolio as they are highly secure institutions but the yeild is much lower (ranging from 0.30% to 0.39%), which in turn reduces our average rate achieved. We maximise interest on fixed term investments with our part-nationalised bank upt o the limits set out in this strategy and have secured a 1 year deal at 1.05% and some 90 day deals at 0.80%. However, the other enhanced rates which could be secured with the part nationalised banks are unable to be achieved as we operate up to our limits with both these banks. We do continue to be above the 7 Day LIBID rate as a benchmark.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits in order to benefit from the compounding of interest.

Investment treasury indicator and limit - 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, and are based on the availability of funds after each year-end.

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

Maximum principal sums invested > 364 days	
Principal sums invested > 364 days	£12m

4.10 Investment risk benchmarking

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

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

- 0.1% historic risk of default when compared to the whole portfolio.

Liquidity – in respect of this area the Council seeks to maintain:

- Liquid short term deposits of at least £1m available with a week's notice.
- Weighted average life benchmark is expected to be 0.3 years, with a maximum of 1.0 years.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.077%**	**0.215%**	**0.367%**	**0.517%**	**0.699%**

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

4.11 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 which is presented at the same time as the Outturn reports.

5. Statutory Officer Comments

5.1 The Monitoring Officer's comments are: No further comments

5.2 -The Section 151 Officer's comments are: Incl~~lc~~uded within the report.

5.3 EIA comments:

5.4 Policy Framework:

5.5 Other Consultee Comments, if any:

List of Background Documents:

Treasury Management Strategy Statement 2013/14

List of Appendices:

Appendix 1 – Interest Rate Forecast
Appendix 2 – Approved Countries for Investment
Appendix 3 – Treasury Management Scheme of Delegation
Appendix 4 – The Treasury Management Role of the s151 Officer

APPENDIX 1: Interest Rate Forecasts 2014 - 2017

Bank Rate	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	-	-	-	-	-

5yr PWLB Rate	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	2.63%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
UBS	2.63%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.63%	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%	-	-	-	-	-

10yr PWLB Rate	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	3.72%	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
UBS	3.72%	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%	-	-	-	-	-
Capital Economics	3.72%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%	-	-	-	-	-

25yr PWLB Rate	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	4.35%	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
UBS	4.35%	4.55%	4.55%	4.80%	4.80%	5.05%	5.05%	5.30%	5.30%	-	-	-	-	-
Capital Economics	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.45%	-	-	-	-	-

50yr PWLB Rate	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	4.31%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
UBS	4.31%	4.45%	4.45%	4.70%	4.70%	4.90%	4.90%	5.05%	5.05%	-	-	-	-	-
Capital Economics	4.31%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%	-	-	-	-	-

APPENDIX 2: Approved countries for investments

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Hong Kong
- Netherlands
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Quatar

AA-

- Belgium
- Saudi Arabia

APPENDIX 3: Treasury management scheme of delegation

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

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

APPENDIX 4: The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.