DRAFT TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS), MINIMUM REVENUE PROVISION POLICY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2015/16

EXECUTIVE MEMBER: Cllr Gillian Troughton
LEAD OFFICER: Angela George, Interim Finance Manager (s151 Officer)
REPORT AUTHOR: Leanne Barwise, Senior Accounting Officer

WHAT BENEFITS WILL THESE PROPOSALS BRING TO COPELAND RESIDENTS?

The Council has a legislative duty to manage its resources effectively and deliver statutory services for the benefit of the Borough. Treasury Management is an important part of this function and is regulated by an approved Treasury Management Strategy Statement (this document) written in accordance with the CIPFA Code of Practice on Treasury Management and forms part of the budget and policy framework.

WHY HAS THIS REPORT COME TO THE EXECUTIVE?

This report is presented today at Executive prior to the Audit and Governance Committee on 29 January 2015 for scrutiny. It will then proceed to Special Executive on 12 February 2015 to seek recommendation to Full Council for approval on 26 February 2015.

The financial projections contained within this report are draft and will be finalised once the Capital Programme for 2015/16, Revenue Budget for 2015/16 and Review of Reserves have been determined.

RECOMMENDATION:

i) Executive recommend to Council for approval on 26 February 2015 the Treasury Management Strategy Statement 2015/16, the Annual Investment Strategy 2015/16 and the Minimum Revenue Provision Statement 2015/16 contained within this report. Executive are asked to recommend this, giving due regard to the following changes from the 2014/15 treasury strategy and subsequent in year revisions to the TMSS and approved in 2014/15:

ii) The inclusion of Property Funds (at paragraph 4.2) which may be used in future years (subject to a further detailed report specifying fund details and financial limits & prior Executive approval).

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 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.

1.2 Copeland's Portfolio and Investment Strategy

Copeland Borough Council holds an average investment portfolio of £20-25m of its own funds. The majority of this money is held in reserves and capital receipts & is earmarked for spend on various projects. The range of funds however can be as high as £55m at the start of the financial year depending on receipt of an advance payment of a full year Business Rates payment from the Council's largest ratepayer of around £30m. This large cash balance at the start of the year does not belong to Copeland Borough Council and is invested in a range of maturities to facilitate the requirement to pay over regular amounts of the advance funding to the Government and County Council in accordance with the agreed schedule of payments.

We receive Council Tax receipts monthly with council tax payers having the option to pay over 10 or 12 months, but again this is not the Council's funds to keep and some must be repaid to our main preceptors, Cumbria County Council and the Police and Crime Commissioner, with the Council retaining only its share of circa £3.5m.

The main principal governing the Council's 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 set in conjunction with our Treasury Management Advisors, Capita Asset Services. This list ultimately limits us to use the counterparties for investment that are above the minimum criteria that we set. 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, with officers using their judgement within the parameters set as required.

Wherever possible we maximise interest on fixed term investments with the part-nationalised banks by securing investments for up to a year and up to the maximum limits (up to £10m each) set out in the strategy. As noted above at peak cash inflow times the Council has c £55m to invest. The Council aims for diversity through the use of other counterparties who meet our minimum criteria and also through the use of Money Market Funds (see paragraph 4.1). These are highly secure, liquid institutions but the yield is generally lower currently yielding around 0.4% but similar to call accounts. 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.

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

1.3 Treasury Management Policy Statement

The Chartered Institute of Public Finance and Accountancy (CIPFA) produce the Code of {ractice on Treasury Managemnent activities and 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."

1.4 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 25 November 2014 updating members with the progress of the capital position, amending prudential indicators as necessary and 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.

1.5 Treasury Management Strategy for 2015/16

The strategy for 2015/16 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.

1.6 Training

The CIPFA Code requires the responsible officer (the S151 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 on 30 January 2014 and further training has been arranged to co-inside with Audit and Governance Committee on 29 January 2015.

The training needs of treasury management officers are reviewed periodically.

1.7 Treasury management Advisors

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors. However 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 2015/16 – 2017/18

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 draft 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 full details of which are elsewhere on the Executive agenda for consideration. The following table summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall in these resources would result in a borrowing need:

Capital expenditure £000's	**2013/14 Actual**	**2014/15 Estimate***	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Total	782	2,864	1,634	607	609
Financed by:					
Capital receipts	335	1,687	808	256	258
Capital grants	447	1,177	601	351	351
Revenue	0	0	225	0	0
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

*estimate based on position at Q2 September 2014

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

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 CFR is 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.

The Council is asked to approve the following CFR projections:

£000's	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Financing Requirement					
Total CFR	7,925	7,393	6,976	6,969	6,592
Movement in CFR	(554)	(532)	(417)	(6)	(377)

Movement in CFR represented by					
Net financing need for the year (above)	-	-	-	-	-
Less MRP and other financing movements	(554)	(532)	(417)	(6)	(377)
Movement in CFR	(554)	(532)	(417)	(6)	(377)

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 currently does not.
Government 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 Government regulations (option 1)*;*

This option provides 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 2.2 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	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Fund balances / reserves	9,108	TBC	TBC	TBC	TBC
Capital receipts	3,623	TBC	TBC	TBC	TBC
Earmarked Reserves	5,818	TBC	TBC	TBC	TBC
Provisions	9,178	TBC	TBC	TBC	TBC
Total core funds	27,727	TBC	TBC	TBC	TBC
Working capital CBC	(5,508)	TBC	TBC	TBC	TBC
Working capital NNDR	TBC	TBC	TBC	TBC	TBC
NNDR Provision	TBC	TBC	TBC	TBC	TBC
Under/over borrowing	(3,455)	TBC	TBC	TBC	TBC
Expected investments	25,674	TBC	TBC	TBC	TBC

*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.

%	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio	7.73	6.95	6.43	5.80	5.43

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 (see definition below) 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

£	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 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 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 make interest payments that total £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.

The Council's treasury portfolio position at 31 March 2014 (detailed above) is summarised below with forward projections. 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 borrowed position.

£000's	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 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)	6,934	6,402	5,985	5,979	5,602
Expected change in OLTL	(554)	(532)	(417)	(6)	(377)
Actual gross debt at 31 March	**11,380**	**10,870**	**10,568**	**10,973**	**10,225**
The Capital Financing Requirement	**7,925**	**7,393**	**6,976**	**6,969**	**6,592**
Under / (over) borrowing	**3,455**	**3,477**	**3,592**	**4,004**	**3,633**

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 s151 officer 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	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 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	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	9,000	9,000	9,000	9,000

Other long term liabilities	8,000	8,000	8,000	8,000
Total expected	**17,000**	**17,000**	**17,000**	**17,000**

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 & fixed interest rate exposure. This identifies a maximum limit for variable & fixed interest rates based upon the debt position net of investments.
- Upper limits on variable & fixed interest rates on investments. This identifies a maximum limit for variable & fixed 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	**2015/16**	**2016/17**	**2017/18**
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:			
• ***Gross debt only***	*5,100*	*5,100*	*5,100*
• ***Gross investments only***	*54,000*	*54,000*	*54,000*
Limits on variable interest rates			
• ***Gross debt only***	*5,100*	*5,100*	*5,100*
• ***Gross investments only***	*54,000*	*54,000*	*54,000*
Maturity structure of fixed interest rate borrowing 2015/16			
		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%

3.3 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.

3.4 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 Council, at the earliest meeting following its action.

3.5 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
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

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. One drag on the economy is that wage inflation has been lower than CPI inflation so eroding disposable income and living standards, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by warranting increases in pay rates. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen in the near future. 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:

- As for the Eurozone, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and a triple dip recession since 2008. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international lack of competition 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. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond;
- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. During July to October 2014, a building accumulation of negative news has led to an overall trend of falling rates. 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 higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- 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.

4. ANNUAL INVESTMENT STRATEGY

Introduction: changes to credit rating methodology

The Council has a pool of counterparties (Banks/Institutions etc.) that are considered high quality which may be used to place investments; this is called the counterparty list. The criteria that form the basis of our counterparty list was reported within the Treasury Management Strategy 2014/15 in February 2014 and approved by Council.

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support (i.e. in the UK Lloyds remains a part nationalised bank). More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and/or 2015/16. The actual timing of the changes is still subject to discussion, but immediate changes to the credit methodology were required as it would be a change to our criteria and subsequently our Counterparty list. Approval was therefore sought to make these changes to the Treasury Management Strategy 2014/15 within the Mid-Year Treasury Management Review Report to Council on 4th December 2014.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied Government support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a ***possibility*** of external support, but it ***cannot be relied upon.***"

With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution (where previously we included the potentially redundant Financial Strength/Viability & Support in addition to these). Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS prices as an overlay to ratings in our new methodology.

4.1 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 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 has below clearly stipulated the minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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.

In recent times our risks have increased, even though our counterparty criteria and limits remain relatively 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 either **'Specified'** Investments (**i.e. investments with maturities of upto a maximum of one year meeting the high quality criteria**) or **'Non-Specified'** investment categories (**i.e. all other investments that do not meet the Specified criteria**). Counterparty limits will be as set through the Council's treasury management practices schedules.

4.2 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:
    i. are UK banks; or
    ii. 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):
    i. Short term – F1
    ii. Long term – A-

- **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

- Property Funds**

* Enhanced MMF's are similar to the current MMF's and should allow marginally higher returns. These funds invest slightly longer than the current liquid MMF's 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.
**Property Funds are longer term investments and although are not currently used by the authority the option may be used in future financial years. Officers will consult with our advisers over their introduction and are subject to an additional report.

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.

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.

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):

Institution Limits	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	*AA-*	£5m	3yrs
Banks 1 medium quality	*A-*	£5m	100 days
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

In an exceptional circumstance the monetary limit in the part nationalised banks (Banks 2) in the table above was temporarily breached for 2 days (one working day and a Bank Holiday). The strategy breach was related to a substantial receipt being received on 31st December 2014 from the DCLG as the Council Offices were closed for Christmas holidays. The receipt was unable to be transferred out of our current account as the money market had closed early prior to the Bank Holiday on New Years Day. We had previously contacted the DCLG to request another payment date however they were unable to accommodate our request as the payment formed part of an automated BACS run. This subsequently resulted in an overnight breach of our self-imposed monetary limits for investments with a part nationalised bank which is resticted within the Treasury Management Strategy Statement to £10m. The funds were invested when the money markets opened for normal trading on 2nd January 2015.

4.3 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 2 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015/16 1.00%
- 2016/17 1.50%
- 2017/18 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

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 eight years are as follows:

2015/16	0.90%
2016/17	1.50%
2017/18	2.00%
2018/19	2.50%
2019/20	3.00%
2020/21	3.00%
2021/22	3.25%

2022/23	3.25%
Later years	3.50%

It should be noted however the above rates are probably unachievable for us as an Authority over the whole portfolio. The average rate we achieved at quarter 2 was below this at 0.40%. 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 lower than base rate (ranging from 0.32% to 0.45%), which in turn reduces our average rate achieved. We maximise interest on fixed term investments with our part-nationalised bank upto the limits set out in this strategy and have secured two 1 year deals at 0.95%. 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 Lloyds and RBS have drastically reduced their rates to as little as 0.40% on some accounts. 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

4.4 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	**TBC**	**TBC**	**TBC**	**TBC**	**TBC**

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

4.5 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: None

5.2 The Section 151 Officer's comments are: Inlcuded within the report.

5.3 EIA comments: None

5.4 Policy Framework: Within Policy Framework

5.5 Other Consultee Comments, if any: None

List of Background Documents:

Treasury Management Strategy Statement 2014/15, Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2014/15

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 as at 5th January 2015

	NOW	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
BANK RATE	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.75	1.75	2.00
3 month LIBID	0.50	0.50	0.50	0.60	0.80	0.90	1.10	1.10	1.30	1.40	1.50	1.80	1.90	2.10
6 month LIBID	0.65	0.70	0.70	0.80	1.00	1.10	1.20	1.30	1.50	1.60	1.70	2.00	2.10	2.30
12 month LIBID	0.93	0.90	1.00	1.10	1.30	1.40	1.50	1.60	1.80	1.90	2.00	2.30	2.40	2.60
5 yr PWLB	2.00	2.20	2.20	2.30	2.50	2.60	2.80	2.90	3.00	3.20	3.30	3.40	3.50	3.60
10 yr PWLB	2.60	2.80	2.80	3.00	3.20	3.30	3.50	3.60	3.70	3.80	3.90	4.00	4.10	4.20
25 yr PWLB	3.30	3.40	3.50	3.70	3.80	4.00	4.20	4.30	4.40	4.50	4.60	4.70	4.70	4.80
50 yr PWLB	3.30	3.40	3.50	3.70	3.80	4.00	4.20	4.30	4.40	4.50	4.60	4.70	4.70	4.80

APPENDIX 2: Approved countries for investments

AAA

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

AA+

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

AA

- Abu Dhabi (UAE)
- France
- Qatar

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.
- Arranging adequate training