

## Treasury Management Strategy Report 2015/16

### INTRODUCTION

#### 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 the 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 may 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.

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."*

#### 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 will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**Governance and Audit** – As part of the committees terms of reference the above reports are presented to them for consideration and scrutiny during the year. The Committee also have delegated authority to approve in year amendments to the Treasury Management Strategy. The committee have also considered and support the investment strategy for 2015/16.

### **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) strategy.

#### 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.

### **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 responsible for scrutiny. Training has been undertaken by members of the Governance and Audit and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

### **Treasury management consultants**

The Council uses Capita Asset Services, Treasury Solutions 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.

**SECTION 1 - THE PRUDENTIAL INDICATORS 2015/16 to 2017/18****Introduction**

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

**The Capital Expenditure Plans**

2. 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:

£m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
Capital Expenditure				
Non-HRA	2.315m	8.417m	1.625m	0.774m
HRA	6.832m	7.371m	7.081m	7.618m
<b>Total</b>	<b>9.147m</b>	<b>15.788m</b>	<b>8.706m</b>	<b>8.392m</b>

3. Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.
4. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

£m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
Capital Expenditure				
Non-HRA	2.315m	8.417m	1.625m	0.774m
HRA	6.832m	7.371m	7.081m	7.618m
Financed by:				
Capital receipts reserve	1.288m	5.060m	1.556m	1.006m
Capital grants	0.361m	0.393m	0.300m	0.000m
Capital reserves	6.119m	7.884m	6.340m	6.876m
Revenue	1.379m	2.451m	0.510m	0.510m
Net financing need for the year	0	0	0	0

**The Council's Borrowing Need (the Capital Financing Requirement)**

5. 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 Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.
6. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst this 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 currently has no such schemes within the CFR
7. The Council is asked to approve the CFR projections below:

£m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
<b>Capital Financing Requirement</b>				
Closing CFR – Non Housing	4.011m	3.851m	3.697m	3.549m
Closing CFR - Housing	115.736m	112.514m	109.292m	106.070m
Opening CFR	123.137m	119.747m	116.365m	112.989m
Movement in CFR	(3.390m)	(3.382m)	(3.376m)	(3.370m)

£m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
<b>Movement in CFR represented by</b>				
Net Financing need for the year (above)	0.00m	0.000m	0.000m	0.000m
Less MRP/VRP and other financing movements	(0.168m)	(0.160m)	(0.154m)	(0.148m)
Movement in CFR	(0.168m)	(0.160m)	(0.154m)	(0.148m)

**Minimum revenue provision (MRP) policy statement**

8. The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary revenue payments (VRP) if required.
9. 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.
10. 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.

11. From 1 April 2008 for all new unsupported borrowing the MRP policy will be:

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

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

12. For authorities who participate in LAMS using the cash backed option, the mortgage lenders require a five year cash advance from the local authority to match the five year life of the indemnity. The cash advance placed with the mortgage lender provides an integral part of the mortgage lending, and should therefore be treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid either annually. Once the cash advance matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position should be reviewed on an annual basis.

### **Core Funds and Expected Investment Balances**

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

Year End Resources £m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
Fund balances	13.894m	14.581m	18.238m	21.856m
Capital reserves	15.264m	12.694m	14.777m	17.952m
HRA reserve	4.882m	3.639m	3.048m	3.023m
Major Repairs Reserve	5.372m	5.710m	5.684m	4.587m
<b>Total Core Funds</b>	<b>39.412m</b>	<b>36.624m</b>	<b>41.747m</b>	<b>47.418m</b>
Working Capital*	<b>1.912m</b>	<b>1.912m</b>	<b>1.912m</b>	<b>1.912m</b>
Expected Investments	<b>41.324m</b>	<b>38.536m</b>	<b>43.659m</b>	<b>49.330m</b>

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

**Affordability Prudential Indicators**

14. 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:

15. **Actual and Estimates of the 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.

%	2014/15 Revised	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
Non-HRA	(0.99%)	(1.13%)	(1.19%)	(1.40%)
HRA	14.72%	14.41%	13.30%	12.42%

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

The Prudential Code 2013 acknowledges that the “Financing costs to Net Revenue Stream” indicator may be more problematic for some authorities regarding the level of government support for capital spends.

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

18. **Incremental impact of capital investment decisions on the Band D Council Tax**

£	2014/15 Revised	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
Variance change in original to revised spending programme	£2.28	£4.35	£0.14	(£0.23)

19. **Estimates of the incremental impact of capital investment decisions on Housing Rent levels –** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council’s

existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

**20. Incremental impact of capital investment decisions Housing Rent levels**

£	2014/15 Revised	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
Variance change in original to revised spending programme	£86.72	£467.84	£565.27	£822.93

21. This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls

The Prudential Code 2013 has clarified that this indicator should relate to the identification and isolation of those decisions members make to the existing capital programme. For instance, the withdrawal of a scheme should be reflected as it may lead to reduced costs and a lower impact on the Council Tax or HRA rents.

**SECTION 2 - Borrowing****Debt and Investment Projections**

22. The capital expenditure plans set out in Section 1 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 appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

**Current Portfolio Position**

23. The Councils treasury portfolio position at 31 March 2014, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (CFR), highlighting any over or under borrowing.

£m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
<b>External Debt</b>				
Existing Debt at 1 April	(116.722m)	(113.487m)	(109.765m)	(106.543m)
Expected change in debt	0.013m	0.500m	0.000m	1.000m
HRA Settlement	3.222m	3.222m	3.222m	3.222m
<b>Debt at 31 March</b>	<b>(113.487m)</b>	<b>(109.765m)</b>	<b>(106.543m)</b>	<b>(102.322m)</b>
<b>CFR</b>	119.747m	116.365m	112.989m	109.619m
<b>Under / (over) borrowing</b>	6.260m	6.600m	6.446m	7.297m
<b>Total Investments at 31 March</b>				
Investment change	<b>41.324m</b>	<b>38.535m</b>	<b>43.659m</b>	<b>49.330m</b>
<b>Net Debt</b>	<b>(72.163m)</b>	<b>(71.230m)</b>	<b>(62.884m)</b>	<b>(52.992m)</b>

24. 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 total debt, net of any investments, 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 2015/16 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes

25. The Corporate Finance Manager 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

**Limits to Borrowing Activity**

26. **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.

Operational Boundary £m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
Debt	1.513m	1.500m	1.000m	1.000m
+ HRA Reform	115.209m	111.987m	108.765m	105.543m
Other long term liabilities	0.000m	0.000m	0.000m	0.000m
<b>Total</b>	<b>116.722m</b>	<b>113.487m</b>	<b>109.765m</b>	<b>106.543m</b>

27. **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.

28. 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 no control has yet been exercised.

29. The Council is asked to approve the following Authorised:

Authorised limit £m	2014/15 Revised £	2015/16 Estimated £	2016/17 Estimated £	2017/18 Estimated £
Debt	18.000m	18.000m	18.000m	18.000m
+ HRA Reform	115.209m	111.987m	108.765m	105.543m
Other long term liabilities	0.000m	0.000m	0.000m	0.000m
<b>Total</b>	<b>133.209m</b>	<b>129.987m</b>	<b>126.765m</b>	<b>123.543m</b>

**Prospects for Interest Rates**

30. The Council has appointed Capita Asset Services, Treasury Solutions as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Annex 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the sector central view

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
<b>Mar 2015</b>	<b>0.50</b>	<b>2.20</b>	<b>3.40</b>	<b>3.40</b>
<b>Jun 2015</b>	<b>0.50</b>	<b>2.20</b>	<b>3.50</b>	<b>3.50</b>
<b>Sep 2015</b>	<b>0.50</b>	<b>2.30</b>	<b>3.70</b>	<b>3.70</b>
<b>Dec 2015</b>	<b>0.75</b>	<b>2.50</b>	<b>3.80</b>	<b>3.80</b>
<b>Mar 2016</b>	<b>0.75</b>	<b>2.60</b>	<b>4.00</b>	<b>4.00</b>
<b>Jun 2016</b>	<b>1.00</b>	<b>2.80</b>	<b>4.20</b>	<b>4.20</b>
<b>Sep 2016</b>	<b>1.00</b>	<b>2.90</b>	<b>4.30</b>	<b>4.30</b>
<b>Dec 2016</b>	<b>1.25</b>	<b>3.00</b>	<b>4.40</b>	<b>4.40</b>
<b>Mar 2017</b>	<b>1.25</b>	<b>3.20</b>	<b>4.50</b>	<b>4.50</b>
<b>Jun 2017</b>	<b>1.50</b>	<b>3.30</b>	<b>4.60</b>	<b>4.60</b>
<b>Sep 2017</b>	<b>1.75</b>	<b>3.40</b>	<b>4.70</b>	<b>4.70</b>
<b>Dec 2017</b>	<b>1.75</b>	<b>3.50</b>	<b>4.70</b>	<b>4.70</b>
<b>Mar 2018</b>	<b>2.00</b>	<b>3.60</b>	<b>4.80</b>	<b>4.80</b>

31. UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling

disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. 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 early in 2015.

The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

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

- Greece: the general election on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;
- As for the Eurozone in general, 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 those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. 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 uncompetitiveness and the need for overdue reforms of the new 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. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight of quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. 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.

### **Borrowing Strategy 2015/16 – 2016/17**

32. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high.
33. Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Corporate Finance Manager will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.
34. The uncertainty over future interest rate increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.
35. The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

### **Treasury Management Limits on Activity**

36. There are three debt related treasury activity limits. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an 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 – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
  - Maturity structures 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.

37. The Council is asked to approve the limits:

£m	2014/15	2015/16	2016/17	2017/18
<b>Interest rate Exposures</b>				
	Upper	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	<b>125.000m</b>	<b>125.000m</b>	<b>125.000m</b>	<b>125.000m</b>
Limits on variable interest rates based on net debt	<b>40.000m</b>	<b>40.000m</b>	<b>40.000m</b>	<b>40.000m</b>
<b>Maturity Structure of fixed interest rate borrowing 2015/16</b>				
	Lower	Upper	Upper	Upper
Under 12 months	0%	<b>40%</b>	<b>0%</b>	<b>0%</b>
12 months to 2 years	0%	<b>40%</b>	<b>40%</b>	<b>40%</b>
2 years to 5 years	0%	<b>100%</b>	<b>100%</b>	<b>100%</b>
5 years to 10 years	0%	<b>100%</b>	<b>100%</b>	<b>100%</b>
10 years and above	0%	<b>100%</b>	<b>100%</b>	<b>100%</b>

**Policy on Borrowing in Advance of need**

38. 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.

39. The Corporate Finance Manager may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Corporate Finance Manager will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

40. It would not look to borrow more than 24 months in advance of need.

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

**Debt Rescheduling**

42. 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, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

43. 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).

44. 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.

### **Municipal Bonds Agency**

45. It is likely that the Municipal Bonds Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This authority intends to make use of this new source of borrowing as and when appropriate.

## **SECTION 3 - ANNUAL INVESTMENT STRATEGY**

### **Investment Policy and Counterparty Selection Criteria**

46. 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.
47. In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.
48. 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.
49. As with previous practice, ratings will not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

50. 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.
51. Investment instruments identified for use in the financial year are listed in annex 3 under the 'specified' and 'non-specified' investment categories. Counterparty limits will be as set through the Council's treasury management practices-schedules.

**Creditworthiness policy**

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

52. 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 suggested duration for investments. The Council will therefore use counterparties within the following durational bands

- Yellow 5 years \*
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

53. The Capita Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

54. Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of short term rating F1, long term rating A-. There may be occasions when the counterparty ratings from one agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
55. All credit ratings are monitored daily and the Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services creditworthiness service.
- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
  - in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
56. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.
57. The Treasury Management Officer will use the Capita Credit Rating weekly listing as a tool for guidance, with the option to deviate from this guidance only when there are clear alternative options that are available to the Council. Any decision of this nature should be clearly documented for audit purposes.

### Local Authority Mortgage Scheme

58. The Local Authority Mortgage Scheme (LAMS) – The Council is currently participating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified/non specified investment categories

### Investment Strategy

59. **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).
60. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before strating to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:
- 2015/16 0.75%
  - 2016/17 1.25%
  - 2017/18 2.00%

61. 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 upside risk.

62. The 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:

- 2015/16 0.60%
- 2016/17 1.25%
- 2017/18 1.75%
- 2018/19 2.25%

63. **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.

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

Maximum principal sums invested > 364 days			
£m	2015/16	2016/17	2017/18
<b>Principal sums invested &gt; 364 days</b>	<b>£10.000m</b>	<b>£11.000m</b>	<b>£12.000m</b>

65. **Investment Risk Benchmarking** – A development in the revised Codes and the CLG Investment Guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature.

66. These benchmarks are simple guides to maximise risk, and so 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 depending on any change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

67. **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.

68. **Liquidity** – In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.25m
- Liquid short term deposits of at least £5m available with a week's notice.
- Weighted Average Life benchmark is expected to not exceed a maximum of 1 year.

**69. Yield - Local measures of yield benchmarks are :**

- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 10% above 7 day compounded LIBID.

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

	1 year	2 years	3 years	4 years	5 years
<b>Maximum</b>	<b>0.08%</b>	<b>0.22%</b>	<b>0.37%</b>	<b>0.52%</b>	<b>0.70%</b>

Note: This benchmark is an average risk of default measure (potential loss on investments), and would not constitute an actual expectation of loss against a particular investment.

**End of year Investment Report**

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

**Policy on Use of External Service Providers**

72. The Council uses Capita Asset Services as its external treasury management advisors.

73. 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.

74. 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.

## Annex 1 - Interest Rate Forecast 2014/2018

Capita Asset Services Interest Rate View													
	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
<b>Bank Rate View</b>	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%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	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	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PW IB Rate	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%
10yr PW IB Rate	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%
25yrPW IB Rate	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%
50yrPW IB Rate	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%
<b>Bank Rate</b>													
Capita Asset Services	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%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
<b>5yr PW IB Rate</b>													
Capita Asset Services	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%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
<b>10yr PW IB Rate</b>													
Capita Asset Services	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%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
<b>25yrPW IB Rate</b>													
Capita Asset Services	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%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
<b>50yrPW IB Rate</b>													
Capita Asset Services	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%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-
Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012													

### Annex 2 – Economic Background

#### **Global economy**

Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues 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 for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

#### **The US economy**

The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

#### **China.**

Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

### Japan

Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

### Greece

The general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

### UK economy

UK. After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt

over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

**Forward guidance.** Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions) will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries.

Increasing investor confidence in eventful world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas. The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crises. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary – but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and/or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crises in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.

- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners – the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government.
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.
- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds and equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

### Annex 3

#### **Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management**

CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 23 June 2004 and will apply its principles to all investment activity. In accordance with the Code, the Corporate Finance Manager has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

**Annual Investment Strategy** - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security, and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

**Strategy Guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

**Specified Investments** – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

Table A – Specified Investments

	<b>Specified Investments Category</b>	<b>Limit</b>
a	<p><b>A body of high credit quality</b>, this category includes the following –</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Any bank or building society using Sector Creditworthiness service, following the suggested duration on the list up to a maximum of 364 days.</li> <li><input type="checkbox"/> Nationalised and Part nationalised banks can be included within specified investments as long as they remain part-nationalised</li> </ul>	<p><b>£10m per institution</b> or a maximum of <b>30% of total investment</b> (whichever is the greatest), <b>£10m per corporate group</b></p>
b	<p><b>The UK Government</b> (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity)</p>	no amount limit
c	<p><b>UK local authorities, Parish Council or Community Council</b></p>	<p><b>£5m per LA, £10m all LAs</b></p>
d	<p><b>Pooled investment vehicles</b> (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This category covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor’s, Moody’s or Fitch rating agencies.</p> <p>CLG Investment Guidance specifies that Money Market Funds with high credit ratings are classified as Specified Investment. These funds are instant access investment. There is possibility that part of the investment may be exposed to counterparties the Council would not approve normally or invest directly. The counterparty risk is mitigated by that –</p> <ul style="list-style-type: none"> <li>• The Fund Managers diversify investment in a range of counterparties;</li> <li>• The Funds are instant access;</li> <li>• The Council only invests in funds rated AAA;</li> <li>• DCLG Investment Guidance classifying such funds as Specified Investment.</li> </ul>	<p><b>£5m per fund,</b></p>
e	<p><b>Enhanced Money Market Funds</b></p> <p>These are similar to normal money market funds but operate on a variable rate basis. The selection criteria will be on the same basis as the pooled investment vehicles with only funds rated AAA by Standard and Poor’s, Moody’s or Fitch rating agencies being used.</p> <p>In addition to this only EMMF’s with a credit score of 1.25 and above will be used.</p>	<p><b>£5m per fund,</b></p>
f	<p><b>Corporate Bond Funds</b></p>	<p><b>£5m per fund</b></p>

**Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

Amounts invested with any one institution shall not exceed £2m for periods of more than 2 years. Amounts invested with any one corporate group shall not exceed £5m (with the exception of Councils own bank).

Amounts invested in non specified fixed term investment would normally not exceed 25% of the total Invested. The Corporate Finance Manager has the discretion if required to exceed the limit which may occur during the course of the year should rate of return on investment be beneficial to the council. Any decision will be based on taking into account current and future market conditions as well counterparty strength and rating. If these circumstances are required this will be reported back to the appropriate committee.

**Table B – Non Specified Investments**

Non Specified Investment Category	Limit
<b>a. Any institutions meeting the criteria set out for Specified Investments</b> , with a maturity of greater than one year following the suggested duration on the list up to a maximum of 2 years. (including forward deals in excess of one year from inception to repayment).	<b>£4m</b> maximum of <b>2-years</b> per institution
<b>b. Councils Bank</b> – Should its ratings fall below that required for specified investment, monies will be restricted to instant access.	<b>£7m</b>
<b>c. Top 10 building societies, by asset value.</b>	<b>£2m</b> maximum of <b>2-years</b> per institution. <b>£6m</b> for all B/S sector
<b>d. Property funds</b> The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	<b>£5m</b> per fund

**Note: This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.**

**The monitoring of investment counterparties** – The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principle and interest. Any counterparty failing to meet the criteria will be removed from the list

immediately by the Corporate Finance Manager, and if required new counterparties which meet the criteria will be added to the list.

**Local Authority Mortgage Scheme.** Under this scheme the Council will place a maximum fund of £5m, with one of the approved lenders participating in the LAMS scheme for a fixed period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the Specified / Non specified categories

### **Registered Social Landlords (RSL's)**

- This scheme would lend amounts up to £5m per investment to Registered Social Landlords for the purpose of providing housing within the District.
- Repayment terms of up to 10 years would be offered.
- Can be deemed as a service investment as apposed to a Treasury Investment.
- Individual Housing Associations do not have credit ratings therefore it is proposed that we use our external treasury advisers to undertake due diligence checks to assess borrowers' ability to make good the repayment of the loan.
- Loans would be secured by means of a legal charge over the borrowers assets. Related legal costs and loan set up fees would be charged to the borrower.
- Interest rates charged would be set based on prevailing PWLB/market rates available at the time the loan is agreed. If a market rate is applied this will provide an investment return. In any event a rate will be charged that ensures that no gratuitous benefit is included which could have soft loan or state aid implications.
- For accounting purposes loans would be treated as capital expenditure and financed from internal borrowing. This will increase the Capital Financing Requirement (CFR) by the amount of the loan and then this will be written down upon repayment of the principal.
- This approach means that there is no requirement to make a Minimum Revenue Provision (MRP) contribution which would be a charge to the working balances, therefore avoiding any additional cost to the tax payer.

**Use of External Fund Managers** –The Council currently uses external fund managers for part of its investment portfolio. The Council is not restricted to placing funds with cash managers, and will manage funds in house, use fund managers, or brokers if it is appropriate to do so.

The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council's investment strategy. Currently the Council has an agreement with King & Shaxson, Tradition UK and Sterling International. The fund managers are required to adhere to the following:

- All investments restricted to sterling denominated instruments;

## Appendix F

- Amounts invested with any one institution or Corporate Group should not exceed the limits specified in Table A and Table B.
- Portfolio management is measured against the return provided by the 3 month sterling LIBID, or in accordance with the measures specified in the contract.

The performance of investment managed by Fund Managers is reviewed at least quarterly by the Corporate Finance Manager.

**Ethical Investment Statement** - The council has approved the following ethical investment statement that will apply to all cash investments made by, or on behalf of, the council

“The Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- encouraging those institutions to adopt and publicise policies on socially responsible investments;
- requesting those institutions to apply council deposits in a socially responsible manner.”

Counterparties shall be advised of the above statement.

**Annex 4**

**Risk Management** – The Council undertakes risk assessment for all fixed term deposits or greater than one month. The risk assessment uses the following template –

**Risk assessment of new investment (last updated March 2011)**

Investment	Institution	Risk Assessment		
Investment Product	Institution name	<i>Risk of the counterparty defaulting on investment</i>		
			<i>Likelihood</i>	
		Counterparty on our specified list: Instant access	1.4	
		Counterparty only on non specified list: Instant access	1.7	
Principal Value	Eligibility	Counterparty on our specified list: <=364 days	2	Unlikely
		Counterparty on our specified list: <=3 months	1	Unlikely
		Counterparty only on non specified list: <=364 days	2.4	
		Counterparty only on non specified list: >364 days	3	Likely
Term	Limit with this institution			
		<i>Impact of losing the investment</i>		
			<i>Impact</i>	
Rate	Existing investment value	Total principal less than £700,000	1	Negligible
		Total principal between £700,000 and £1.4m	2	Minor
		Total principal between 1.4m and £3.5m	3	Major
Rate %	Value inc new investment	Total principal greater than £3.5m	4	Critical
		<b>Risk Score :</b>		
Internal Reference	Is it within the limit?			

Risk assessed by:

Risk assessment date: