COUNCIL – 23RD FEBRUARY 2015

Report of the Cabinet

ITEM 8.2 TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION STRATEGY FOR 2015-16

Purpose of Report

To set out the Treasury Management Strategy Statement, the Annual Investment Strategy and Minimum Revenue Provision Strategy, for consideration and approval.

Recommendations

1. That the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy, as shown as an Appendix to the report of Cabinet, attached as an Annex, be approved; and

2. that the Prudential and Treasury Indicators set out in sections 2 and 3 of the Strategy be approved.

Reasons

1. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.

2. To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

Policy justification detailed in the attached Appendix.

At its meeting on 12th February 2015, Cabinet considered a report of the Head of Finance and Property Services setting out the Treasury Management Strategy Statement for consideration by Council as well as the Annual Investment Strategy and Minimum Revenue Provision Strategy, which is attached as an Appendix. The Overview Scrutiny Group had also undertaken pre-decision scrutiny of the report and had supported the officer recommendations.

Cabinet ***RESOLVED****:*

1. ***that it be recommended to Council*** *that the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy, as detailed in the Appendix to the report of the Head of Finance and Property Services, filed with these minutes, be approved;*

2. ***that it be recommended to Council** that the Prudential and Treasury Indicators, as detailed in sections 2 and 3 of the Appendix to the report of the Head of Finance and Property Services, filed with these minutes, be approved;*

3. *that the Overview Scrutiny Group be thanked for its work and that its report be noted.*

Reasons

1. *To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.*

2. *To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.*

3. *To acknowledge the work undertaken and the views of the Overview Scrutiny Group.*

Implementation Timetable including Future Decisions and Scrutiny

This report will be considered by the Audit Committee at its meeting on 3rd March 2015.

Report Implications

As detailed in the attached Annex.

Key Decision:	Yes
Background Papers:	No additional background papers.
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ANNEX

CABINET – 12TH FEBRUARY 2015

Report of the Head of Finance and Property Services
Lead Member: Councillor Tom Barkley

Part A

ITEM 8 TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION STRATEGY FOR 2015-16

Purpose of Report

This report sets out the Treasury Management Strategy Statement for consideration by Council as well as the Annual Investment Strategy and Minimum Revenue Provision Strategy.

Recommendations

That it be recommended to Council:

1. That the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy as shown as an Appendix to this report be approved;

2. That the Prudential and Treasury Indicators set out in sections 2 and 3 of the Strategy be approved.

Reasons

1. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.

2. To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential and Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly. The Strategies for the year are set out in the appendix to the report.

Implementation Timetable including Future Decisions and Scrutiny

This report will be considered Overview Scrutiny Group on 9th February 2015, should they wish to consider it, and will also be considered by the Audit Committee at its meeting on 3rd March 2015.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no direct financial implications arising from this report and all relevant financial issues are covered in the strategy.

Risk Management

Risk Identified	Likelihood	Impact	Risk Management Actions Planned
Poor investment decisions due to no strategy in place	Unlikely	Moderate	Approve strategy in accordance with CIPFA guidelines and best practice
Loss of council funds through failure of borrowers	Unlikely	Major/Severe	Credit ratings and other sources used to minimise risks
Market changes rapidly during year	Possible	Minor	Although strategy in place, important to monitor position and use Treasury Consultants and other sources to provide latest advice.
Failure to take effects of Capital Expenditure, when approved, into the budgetary process.	Unlikely	Minor	Robust procedures to approve Capital Plan after all effects have been considered and evaluated by officers and members.
Exposure to interest rates moving adversely without notice	Unlikely	Major	Treasury Consultants engaged to advise of changing interest rate scenarios affecting the Council. Any new borrowings for the HRA would probably be at fixed rates.

Key Decision:	Yes
Background Papers:	None
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Part B

Background

1. The Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy must be approved by Council each year. These are all set out in the attached appendix.

2. The Treasury Management and Annual Investment Strategy have been prepared in accordance with the revised code and accordingly include:

   - the treasury limits in force which will limit the treasury risk and activities of the council,
   - the Prudential and Treasury Indicators
   - the current treasury position,
   - the borrowing requirement,
   - prospects for interest rates,
   - the borrowing strategy,
   - policy on borrowing in advance of need,
   - debt rescheduling,
   - the investment strategy,
   - creditworthiness policy,
   - the use of external fund managers and treasury advisers,
   - Minimum Revenue Provision (MRP) strategy.

Appendix

Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy for 2015-16.

APPENDIX

Charnwood Borough Council

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2015/16

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1 INTRODUCTION

1.1 Background

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

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to 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."*

1.2 Reporting requirements

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

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:
- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This 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.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee and the reports are also available for consideration by the Overview Scrutiny Group.

1.3 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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny and suitable training is provided for memebrs on a periodic basis. The training needs of treasury management officers are reviewed annually.

1.5 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.

2 THE CAPITAL PRUDENTIAL INDICATORS 2015/16 – 2017/18

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to note the capital expenditure forecasts:

Capital Expenditure	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
£'000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
General Fund	1,465	3,031	1,695	890	1,000
HRA Total	11,657	8,242	11,498	8,552	13,223
Total	**13,122**	**11,273**	**13,193**	**9,442**	**14,223**

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.

Capital Expenditure	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
£'000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Total as per above table	13,122	11,273	13,193	9,442	14,223
Financed by:					
Capital receipts	47	256	0	0	0
Capital grants, MRA	6,028	3,533	9,402	6,124	6,100
Capital reserves	0	1,700	1,115	740	1,500
Revenue	5,847	4,622	2,676	2,578	2,440
Internal Borrowing	1,200	1,162	0	0	4,183
External Borrowing	0	0	0	0	0
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

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 above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The Council is asked to note the CFR projections below:

£'000	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Capital Financing Requirement					
CFR – non housing	20	20	20	20	20
CFR - housing	81,820	81,820	81,820	81,820	86,003
Total CFR	**81,840**	**81,840**	**81,840**	**81,840**	**86,023**
Movement in CFR	**1,200**	**0**	**0**	**0**	**4,183**

£'000	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Movement in CFR represented by:					
Net financing need for the year (above)	1,200	0	0	0	4,183
Less MRP and other financing movements	0	0	0	0	0
Movement in CFR	**1,200**	**0**	**0**	**0**	**4,183**

2.3 Minimum revenue provision (MRP) policy statement

The Council currently has an overall negative capital financing requirement for the General Fund and therefore does not have to make a MRP provision. If the Council, in the future, funds capital expenditure from borrowing, then a policy will need to be adopted in line with the options set out in government guidance. At that time the most appropriate option would be adopted.

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 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.

The current Capital Plan, which runs through to March 2017, is adequately funded from capital receipts, reserves, internal borrowing and revenue funding. For 2017/18 the General Fund capital expenditure is assumed to be at a similar level to current amounts and the HRA figure is based on the 30 Year HRA Business Plan. Any new proposals for additional capital expenditure will be considered on their merits and the availability of funding. The funding position is regularly reviewed and any need to borrow will be considered in future Treasury Management Strategies.

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 note 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
General Fund	0.40	0.33	0.10	-0.63	-1.35
HRA	12.06	12.59	12.07	11.68	11.82

The estimates of financing costs include current commitments and the proposals in the 2015/16 budget report.

2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed Capital expenditure 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. The impact for 2013/14 was nil and it is expected to continue at nil through to March 2018.

2.8 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 the current Capital Plan and Business Plan, expressed as a discrete impact on weekly rent levels. As with the Council Tax calculation this is also nil in all years except for 2015/16 where the effect is a negative £0.01, one pence per week.

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

2.9 HRA ratios

This table shows the ratio of HRA debt to total HRA revenues. Whilst the debt level remains stable over the first four years the ratio will reduce as the revenues increase. This will reverse in 2017/18.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
HRA debt £'000	81,820	81,820	81,820	81,820	86,003
HRA revenues £'000	22,679	22,958	22,881	23,726	24,286
Ratio of debt to revenues %	361%	356%	358%	345%	354%

This second table shows the amount of debt per dwelling and this increases due to the level of Right to Buy disposals as well as an expected increase in the debt in 2017/18.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
HRA debt £'000	81,820	81,820	81,820	81,820	86,003
Number of HRA dwellings	5,784	5,745	5,720	5,695	5,680
Debt per dwelling £	14,146	14,242	14,304	14,367	15,141

3 BORROWING

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

3.1 Current portfolio position

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

£'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
External Debt					
Debt at 1 April	81,190	81,190	81,190	81,190	81,190
Expected change in Debt	0	0	0	0	0
Actual debt at 31 March	**81,190**	**81,190**	**81,190**	**81,190**	**81,190**
The Capital Financing Requirement	**81,840**	**81,840**	**81,840**	**81,840**	**86,023**
Under / (over) borrowing	**650**	**650**	**650**	**650**	**4,833**

This 'under borrowed' position is caused by the Council funding some HRA expenditure through internal rather than external borrowing, offset by the HRA having had a negative CFR prior to the HRA settlement in 2012.

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 2015/16 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 Council has 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 the 2015/16 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.

Operational boundary £'000	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Debt	81,190	81,190	81,190	81,190
Other long term liabilities	0	0	0	0
Total	**81,190**	**81,190**	**81,190**	**81,190**

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

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

Authorised limit £m	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Debt	96,000	96,000	96,000	96,000
Other long term liabilities	0	0	0	0
Total	96,000	96,000	96,000	96,000

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £'000	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
HRA debt cap	88,770	88,770	88,770	88,770
HRA CFR	81,820	81,820	81,820	86,003
HRA headroom	6,950	6,950	6,950	2,767

3.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

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

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 brought a political party to power which is anti EU and anti austerity. However, if this 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 strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;

- As for the Eurozone in general, 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 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 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 to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and the ECB commencing quantitative easing (purchase of EZ government debt) in early 2015;

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing strategy

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 relatively high. At present it is not anticipated that further external boorowings will be undertaken over the life of this strategy.

Treasury management limits on activity

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

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

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

£m	2015/16	2016/17	2017/18
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100	100	100
Limits on variable interest rates based on net debt	90	90	90
Maturity structure of fixed interest rate borrowing 2015/16			
		Lower	**Upper**
Under 12 months		0%	5%
12 months to 2 years		0%	10%
2 years to 5 years		0%	20%
5 years to 10 years		0%	30%
10 years to 20 years		0%	35%

20 years to 30 years	0%	50%
30 years to 40 years	0%	15%
40 years to 50 years	0%	20%
Maturity structure of variable interest rate borrowing 2015/16		
	Lower	Upper
Under 12 months	0%	5%
12 months to 2 years	0%	10%
2 years to 5 years	0%	20%
5 years to 10 years	0%	20%
10 years and above	0%	20%

3.5 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.

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.

3.6 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, 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).

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.

The Council currently has one long term variable rate debt which matures in 2024 and it carries a current interest rate of 11.625%. The cost of replacing this debt is prohibitive and this position is unlikely to change in the next three years.

The £79.19m of HRA debt is at fixed interest rates and the twenty four loans are repayable from 2024 to 2061. Their maturity dates are set to match income and expenditure levels in the HRA Business Plan and they will be reviewed in line with that plan. However, the primary objective of the plan over the next few years is to invest in the Council's housing stock and this position is not expected to change in the near future. Therefore these debts are unlikely to be rescheduled over the next three years

All rescheduling will be reported to the Cabinet at either the half year or full year report stage.

4 ANNUAL INVESTMENT STRATEGY

Introduction: changes to credit rating methodology

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. 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 or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

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 sovereign 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 CAS's future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This 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, CAS will continue to utilise CDS prices as an overlay to ratings in their 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, then return.

In accordance with the above guidance from the Government 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.

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.

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.

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.

Investment instruments identified for use in the financial year are listed in appendix 5.1 under the ‘specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices.

4.2 Creditworthiness policy

The 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.

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:

- 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

The 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.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating 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.

All credit ratings will be monitored at least weekly. The Council is alerted to changes to ratings of all three agencies through its use of CAS's 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.

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 sovereign support for banks and the credit ratings of that supporting government.

If a counterparty is downgraded whislt funds are invested with it then each case will be considered on its merits by the S.151 Officer and notified to the Lead Member.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 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 4 of 2015. Bank Rate forecasts for financial year ends (March) are:

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

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.

The 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, with the Council's target return in brackets:

2015/16	0.60%	(0.74%)
2016/17	1.25%	(1.33%)
2017/18	1.75%	(1.90%)

Investment treasury indicator and limit - total principal funds are not currently invested for greater than 364 days. However, if the Council wished to do so then the treasury indicator and limit would be:

Maximum principal sums invested > 364 days			
£m	**2015/16**	**2016/17**	**2017/18**
Principal sums invested > 364 days	£8m	£9m	£10m

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.

5 APPENDICES

1. Treasury management practice 1 – credit and counterparty risk management
2. Approved countries for investments
3. A list of investments as at 27 January 2015 for information only

5.1 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable. The council currrently only invests in Specified Investments.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	Max £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	Unlimited	12 months
UK Government Treasury bills	UK sovereign rating	Unlimited	12 months
Money market funds	AAA	£5m any one institution and £12m in total	Liquid
Local authorities	N/A	£4m any one institution and £8m in total	12 months
Term deposits with banks and building societies	Purple	£8m any one institution and £12m in total	Up to 12 months
	Blue	£7m any one institution and £12m in total	Up to 12 months
	Orange	£6m any one institution and £12m in total	Up to 12 months

	Red Green No Colour	£5m any one institution and £20m in total £5m any one institution and £15m in total Nil	Up to 6 Months Up to 100 days Not for use

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

5.2 APPENDIX: Approved countries for investments

Based on lowest available rating

AAA

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

AA+

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

5.3 APPENDIX: Current Investments as at 27 January 2015 for information only.

For illustrative purposes only we set out below the Council's investments as at 27 January 2015. Please note that these investments alter on a daily basis.

Institution	**Colour**	**Amount £m**	**Maturity Date**
Bank of Scotland/Lloyds	Blue	**1.0**	1 Dec 2015
Bank of Scotland/Lloyds	Blue	**6.0**	1 Sep 2015
Svenska Handelsbanken AB	Orange	**5.6**	1 Day
HSBC Bank Plc	Orange	**1.5**	3 Feb 2015
Nationwide BS	Red	**3.0**	3 Feb 2015
Nationwide BS	Red	**2.0**	24 Apr 2015
Barclays Bank Plc	Red	**2.0**	9 Mar 2015
Santander UK	Red	**5.0**	1 Day
Deutsche Bank AG	Green	**5.0**	95 Days
Money Market Funds	AAA	**10.0**	1 Day
TOTAL	-	**£41.1m**	-