Committee: Executive Board
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North Kesteven District Council

Report Title: Treasury Management Strategy 2015-16

1 BACKGROUND

1.1 The Capital Expenditure and Treasury Management procedures are now firmly established within the Council. The Council has freedom over capital expenditure so long as it is prudent, affordable and sustainable. In order to show it is working within these limits the Council must approve, revise and monitor at least a basic range of prudential indicators/limits covering the forthcoming three years.

1.2 The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. This report revises the indicators/limits for 2014/15, 2015/16 and 2016/17, and introduces new indicators for 2017/18. Each indicator either summarises the expected activity or introduces limits upon the activity, and reflects the outcome of the Councils underlying capital appraisal systems.

1.3 Within this overall prudential framework there is a clear impact on the Council's treasury management activity, either through borrowing or investment activity. As a consequence, the treasury management strategy for 2015/16 to 2017/18 is included to complement the indicators. Some of the indicators are shown in the treasury management strategy to aid understanding. The production of the treasury management strategy is a requirement of the CIPFA Code of Practice on Treasury Management. Compliance with this Code is required by the Prudential Code.

CIPFA Requirements

The updated Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by this Council on 20th January 2011.

The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c. Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a quarterly Review and an Annual Report (stewardship report) covering activities during the previous year.

d. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

e. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

2 CAPITAL EXPENDITURE PLANS

2.1 The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This capital expenditure will need to take into account the following:

- Service Objectives
- Stewardship Of Assets
- Value For Money
- Prudence And Sustainability
- Affordability
- Practicality
- Revenue Consequences

2.2 This expenditure is partially funded by resources such as capital receipts, capital grants etc. Any remaining expenditure which cannot be immediately funded from other resources will form a borrowing need.

2.3 The key risks to the capital expenditure plans are that the level of Government grants have been estimated and is therefore subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance, anticipated asset sales may be postponed due to the impact of the recession on the property market

2.4 The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:-

Capital Expenditure	**2014/15 Original**	**2014/15 Projected**	**2015/16 Estimated**	**2016/17 Estimated**	**2017/18 Estimated**
	£	£	£	£	£
Non HRA	2,851,300	2,489,600	9,935,500	3,577,600	858,900
HRA	17,861,800	11,425,800	10,980,500	9,172,900	13,196,900
Total Expenditure	**20,713,100**	**13,915,400**	**20,916,000**	**12,750,500**	**14,055,800**
Financed By:					
Capital Receipts	565,600	169,200	975,200	322,300	322,300
Capital Grants	540,500	602,000	875,000	397,900	755,600
Capital Reserves	9,447,200	8,344,200	12,486,800	6,825,300	5,027,900
Revenue	0	0	0	0	0
Net Financing Need	**10,159,800**	**4,800,000**	**6,579,000**	**5,205,000**	**7,950,000**
Analysis:					
Housing Revenue Account	9,959,800	4,800,000	4,154,000	3,550,000	7,850,000
General Fund	200,000	0	2,425,000	1,655,000	100,000
Net Financing Need	**10,159,800**	**4,800,000**	**6,579,000**	**5,205,000**	**7,950,000**

2.5 The above table shows a borrowing requirement for the capital programme from 2014/15 onwards although it is not anticipated that the General Fund will take up this requirement until 2015/16. All the relevant indicators have been calculated on this basis.

2.6 With longer term borrowing rates currently around 3.5% and short term lending rates up to 1%, it makes more economic sense to use existing cash balances to fund the capital programme in the short term rather than to borrow. It is anticipated that this situation will continue until 2015/16 when interest rates are expected to rise to a level where borrowing will become a more suitable option. Money Market rates will be kept under review and borrowing may be undertaken prior to 2015/16 should this become the more suitable option. This will be reported at the earliest opportunity after any borrowing has been undertaken.

3.0 THE COUNCIL'S BORROWING NEED (THE CAPITAL FINANCING REQUIREMENT)

3.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure that has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The net capital financing need identified in paragraph 2.4 above, will impact directly on the CFR.

3.2 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 payments (VRP).

3.3 The Department For Communities and Local Government Regulations require the Full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils to replace the existing Regulations, so long as there is a prudent provision.

3.4 The Council is required to approve the following MRP Statement:

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

Existing practice - MRP will follow the existing practice outline in former CLG Regulations

From 1 April 2008 for all 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);

Finance Leases - MRP will be calculated as being equal to the element of the rental/lease charge that goes to write down the balance sheet liability.

3.5 The Council is asked to approve the CFR projections:-

Year End Resources	2013/14 Actual	2014/15 Projected	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
Capital Financing Requirement	£	£	£	£	£
CFR Non Housing	8,189,967	7,512,944	9,340,449	10,465,835	9,933,392
CFR Housing	70,880,644	73,595,078	73,721,277	74,932,377	80,315,143
Total CFR	79,070,611	81,108,022	83,061,726	85,398,212	90,248,535
Movement In CFR	3,941,675	2,037,411	1,953,704	2,336,486	4,850,323
Represented By:					
Net Financing Need For Year	6,689,778	4,800,000	6,579,000	5,205,000	7,950,000
MRP/VRP & Other Movements	(2,748,103)	(2,762,589)	(4,625,296)	(2,868,514)	(3,099,677)
Movement In CFR	3,941,675	2,037,411	1,953,704	2,336,486	4,850,323

4 THE USE OF THE COUNCIL'S RESOURCES AND THE INVESTMENT POSITION

4.1 The application of resources (capital receipts, reserves etc) to either finance capital expenditure or 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	2014/15 Original	2014/15 Projected	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
	£	£	£	£	£
Fund Balances	2,778,800	2,114,200	1,952,900	1,952,900	1,952,900
Capital Receipts	615,700	850,600	315,800	315,800	315,800
Earmarked Reserves	8,649,200	15,450,700	13,629,300	18,011,100	24,486,500
Total Core Funds	12,043,700	18,415,500	15,898,000	20,279,800	26,755,200
Working Capital	(16,903,748)	(15,785,790)	(10,241,897)	(11,331,590)	(20,593,183)
Under/(Over) Borrowing	12,860,048	8,370,290	7,343,897	5,051,790	7,837,983
Expected Investments	8,000,000	11,000,000	13,000,000	14,000,000	14,000,000

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

5 LIMITS TO BORROWING ACTIVITY

5.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well-defined limits.

5.2 For the first of these 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 next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

	2014/15 Outturn	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
	£	£	£	£
Debt 1 April	74,090,867	72,005,300	75,183,067	79,904,167
Loan Repayments	(2,085,567)	(5,022,233)	(2,478,900)	(2,680,567)
New Borrowing	0	8,200,000	7,200,000	4,900,000
Debt 31 March	72,005,300	75,183,067	79,904,167	82,123,600
CFR	81,108,022	83,061,726	85,398,211	90,248,535
Under/(Over) Borrowing	9,102,722	7,878,659	5,494,044	8,124,935

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

5.4 A requirement of the HRA reform settlement made at the end of 2011/12 was that the HRA cannot have an external debt greater that that laid down in the settlement.The following table shows the estimated debt levels compared to this limit:

	2014/15 Outturn	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
	£	£	£	£
Maximum In Year Debt Position	70,089,688	73,504,121	73,584,653	74,375,753
Settlement Debt Limit	80,070,000	82,124,000	82,124,000	82,124,000
Over/Under	9,980,312	8,619,879	8,539,347	7,748,247

5.5 Two further prudential indicators that controls or anticipates the overall level of borrowing are:-

- **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.

  The Council is asked to approve the following operational boundary:-

Operational Boundary	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
	£	£	£	£
Debt	88,090,867	94,705,300	96,746,400	99,047,500
Other Long Term Liabilities	732,432	534,762	442,255	286,952
Total	88,823,299	95,240,062	97,188,655	99,334,452

- **The authorised limit for external debt** – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Board. 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. 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.

  The Council is asked to approve the following authorised limit:

Authorised Limit For External Debt	2014/15 Estimated	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
	£	£	£	£
Borrowing - HRA	80,070,000	82,124,000	82,124,000	82,124,000
Borrowing - General Fund	6,595,254	8,525,687	8,599,580	8,270,107
Short Term Borrowing	12,000,000	12,000,000	12,000,000	12,000,000
Contingency	3,449,800	3,546,300	3,550,000	3,533,500
Other Long Term Liabilities	732,432	534,762	442,255	286,952
Total	102,847,486	106,730,749	106,715,835	106,214,559

6 **AFFORDABILITY PRUDENTIAL INDICATORS**

6.1 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 overall Council's finances. The Council is asked to approve the following indicators:

6.2 **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.

Ratio of financing costs to net revenue stream

	2013/14 Actual	2014/15 Estimate	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
Non HRA	5.61%	6.20%	5.86%	5.64%	6.55%
HRA	16.53%	16.22%	15.82%	15.78%	16.03%

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

6.4 **Estimates of the 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 report compared to the councils existing approved commitments and current plans. The assumptions are based on the Council's budgets and will therefore include some estimates, such as the level of government support, which is not published over a three-year period.

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

	2013/14 Actual	2014/15 Revised	2015/16 Estimated	2016/17 Estimated	2017/18 Estimated
Council Tax Band D	0.20	0.33	0.88	1.86	0.21

6.6 **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.

6.7 **Incremental impact of capital investment decisions Housing Rent levels**

	2013/14 Actual	2014/15 Revised	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Weekly Housing Rent Levels	(0.31)	(0.91)	(0.29)	0.27	1.47

6.8 This indicator shows the revenue impact on any newly approved schemes, although any discrete impact will be constrained by rent controls.

6.9 The prudential code 2013 recommended further indicators in relation to the Housing Revenue Account (HRA) :

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA Debt £m	70.100	68.000	69.500	71.300	72.400
HRA Revenues £m	15.2	15.6	15.9	16.4	16.8
Ratio Of Debt To Revenues	4.61	4.36	4.37	4.35	4.31

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA Debt £m	70.100	68.000	69.500	71.300	72.400
Number Of HRA Dwellings	3826	3820	3900	3900	3900
Debt Per Dwelling £m	18,322	17,801	17,821	18,282	18,564

7 TREASURY MANAGEMENT STRATEGY 2015/16 – 2017/18

7.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators above consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service covers the effective funding of these decisions. Together they form part of the process which ensures the Council meets the balanced budget requirement under the Local Government Act 1992.

7.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2009). As a result of adopting the code, the Council also adopted a Treasury Management Policy Statement. This adoption meets the requirements of the first of the treasury prudential indicators. However, the revised Code of Practice has amended the Treasury Management Policy Statement and this is appended at appendix 5 for approval

7.3 The constitution requires an annual strategy to be reported to the Board outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report. The Board already receives a quarterly report on the Councils treasury activities which is in excess of the requirements of the revised code.

7.4 This strategy covers:-

- The Councils debt and investment projections.
- The expected movement in interest rates
- The Council's borrowing and investment strategies
- Treasury performance indicators
- Specific limits on treasury activities
- Prudential and Treasury Indicators
- The current treasury position

- The policy on borrowing in advance of need
- Debt rescheduling
- The policy of the use of external service providers
- Any local treasury issues

8 DEBT AND INVESTMENT PROJECTIONS 2015/16 – 2017/18

8.1 The borrowing requirement comprises the expected movement in the CFR and any maturing debt which needs to be re-financed. The table below shows this effect on the treasury position over the next three years. The expected maximum debt provision during each year represents the Operational Boundary prudential indicator and so may be different from the year end position. The table also highlights the expected change in investment balances.

	2014/15 Original	2014/15 Revised	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing Requirement	£	£	£	£	£
Debt 1st April	74,090,866	74,090,867	72,005,300	75,183,067	79,904,167
Change In Debt - HRA	700,000	0	5,500,000	4,200,000	3,500,000
Change In Debt - GF	0	0	2,700,000	3,000,000	1,400,000
Loan Repayments	(2,097,234)	(2,085,567)	(5,022,233)	(2,478,900)	(2,680,567)
Debt 31st March	72,693,632	72,005,300	75,183,067	79,904,167	82,123,600
Operational Boundary	96,071,179	88,823,299	9,520,062	97,188,655	99,334,452
Investments					
Total Investments 31st March	8,000,000	11,000,000	13,000,000	14,000,000	14,000,000
Investment Change	(6,500,000)	3,000,000	2,000,000	1,000,000	0

8.2 The related impact of the above movements on the revenue budget are:

	2014/15 Original	2014/15 Revised	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Revenue Budgets	£	£	£	£	£
Interest On Borrowing	2,779,883	2,714,972	2,923,151	2,887,346	3,085,962
Related HRA Charge	2,519,094	2,454,183	2,569,315	2,547,880	2,647,195
Net General Fund Cost	260,789	260,789	353,836	339,466	438,767
Gross Investment Income	388,028	464,301	320,575	314,488	268,172

9 EXPECTED MOVEMENT IN INTEREST RATES

9.1 The Council appointed Capita Asset Services as a Treasury Adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Capita Asset Services view on future interest rates:-

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

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 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, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and 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 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.

10 BORROWING STRATEGY 2015/16 – 2017/18

10.1 The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

10.2 There has been little recent movement in either short or long term rates and this situation is not expected to change over the short term. The Deputy Chief Executive, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

10.3 With the likelihood of long term rates increasing in the medium to long term, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Deputy Chief Executive and treasury advisors will monitor prevailing rates for any opportunities during the year.

10.4 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 and will be maintained until such time as there is a need for the borrowing.

10.5 Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Deputy Chief Executive may do this under delegated powers 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

Deputy Chief Executive 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. Borrowing in advance will be made within the constraints that

- It will be limited to no more than 100% of the expected increase in borrowing need (CFR) over the three year planning period; and
- The Council would only look to borrow for schemes that are in the currently approved capital programme.

Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the quarterly reporting mechanism.

10.6 The council's present overall external borrowing is set out in appendix 1

11 DEBT RESCHEDULING

11.1 Debt rescheduling is a means of replacing existing loans that are due to be repaid within the relatively near future with variable or fixed rate loans that can be secured at present low rates of interest.

11.2 The reasons why rescheduling could be worth undertaking include:-

- The generation of long term savings at minimum risk:
- Enhancement of the balance of the long term portfolio i.e. improve the debt maturity profile and/or the balance of volatility

11.3 Any rescheduling that is undertaken by the Deputy Chief Executive under delegated powers will be reported to the Executive Board at the meeting following this action.

11.4 In light of current market conditions where the rate of return received on investments is lower than that paid on long term loans, it may be worth considering using cash balances to repay loans either early or when they mature. This would need to be considered in conjunction with the Treasury Management advisors.

12 INVESTMENT STRATEGY 2015/16 – 2017/18

12.1 The Councils in house managed funds are made up of fund balances, reserves and cash flow surpluses. Investments will accordingly be made with reference to the estimated movement in the funds/reserve, cash flow requirements and the outlook for short term interest rates. All investments will be in sterling.

12.2 **Key Objectives -** The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective. Following the economic background above, the current investment climate has one over-riding risk consideration, that of counterparty security risk.

12.3 **Risk Benchmarking** – A development in the revised Codes and the CLG consultation paper 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.

12.4 These benchmarks are simple targets (not limits) 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 changes. Any breach of the benchmarks will be reported, with supporting reasons in the quarterly reports.

12.5 Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

12.6 **Liquidity** – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank Overdraft – agreed maximum net £500,000, although daily cash management ensures this is around zero.
- Sufficient short term cash to cover estimated outgoings over the next 2 week period.

12.7 Security of the investments – In the context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over a 30 year period.

Long Term Rating	1 Year	2 Years	3 Years	4 Years	5 Years
AA	0.017%	0.038%	0.137%	0.271%	0.384%
A(A-)	0.087%	0.237%	0.425%	0.610%	0.861%
BBB	0.201%	0.595%	1.025%	1.519%	2.000%

12.8 The Council's minimum long term rating criteria is currently "A-", meaning the average expectation of default for a one year investment in a counterparty with a "A-" long term rating would be 0.087% of the total investment (e.g. for a £1m investment the average loss would be £870). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

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

- **2.000% historic risk of default when compared to the whole portfolio.**

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

	1 Year	2 Years	3 Years	4 Years	5 Years
Maximum	0.087%	0.237%	0.425%	0.610%	0.861%

12.10 These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Investment Annual Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

12.11 If any of the Councils investments appear at risk of loss due to default(i.e. is a credit related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount. The Council currently has no investments at risk.

12.12 Yield - Local measures of yield benchmarks are

- Investments – Internal returns above the 7 day LIBID rate

12.13 **Sensitivity to Interest Rate Movements**

Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to treasury management costs/income for the next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	Estimate	Estimate
	+1%	-1%
Revenue Budgets	0	0
Interest On Borrowing	0	0
Related HRA Charge	0	0
Net General Fund Cost	0	0
Gross Investment Income	14,642	(14,642)

12.14 A schedule of the Council's current investments is shown in Appendix 3.

13 INVESTMENT COUNTERPARTY AND LIQUIDITY FRAMEWORK

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

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

13.2 The Deputy Chief Executive will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

13.3 The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Code of Practice.

13.4 Credit rating information is supplied by the treasury advisors on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any ratings changes, ratings watches (notifications of any likely change), ratings outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with others being reviewed in light of market conditions.

13.5 The criteria for providing a pool of high quality investment counterparties (for both Specified and Non Specified investments) is:

UK Banks and Building Societies that have as a minimum the following Fitch, Moody's and Standard and Poors credit ratings:

- Short Term – F2
- Long Term – A-
- UK institutions that continue to meet the minimum rating criteria above will continue to be used in the event of a UK sovereign downgrade.
- Part nationalised banks – Lloyds and RBS Banking Groups. These will continue to be used so long as they continue to meet the minimum rating criteria above or remain part nationalised.
- With the phasing out of the Governments Eligible Institutions Scheme, the top 10 rated building societies based on asset size.
- Non UK Banks in countries that have a minimum sovereign rating of AAA and meet the above UK Banks and Building Societies criteria. Please see appendix 2 for a complete list of Non UK institutions and their current credit rating. This is a new criteria as Non UK institutions have not previously been used.

Other Institutions

- Money Market Funds – AAA
- Enhanced Cash Funds
- UK Government (including gilts and the DMADF)
- All Local Authorities
- Supranational institutions such as The World Bank or the European Investment Bank.

13.6 **SPECIFIED AND NON-SPECIFIED INVESTMENTS**

Specified Investments

13.7 In accordance with The Local Government Investment Guidance under S15(1)(a) of the Local Government Act 2003, the specified instruments approved for investment and those most commonly used by local authorities are:-

- Deposits with banks, building societies and local authorities (and certain other bodies
- AAA rated bonds deposit facility
- Eligible institutions
- Debt Management Account (run by the DMO/PWLB)
- Listed Securities
- Supranational Bonds of less than one year duration
- A local Authority, Parish Council or Community Council
- Pooled Investment Vehicles such as Money Market Funds

13.8 These specified investments are in sterling and must not exceed one year unless the Council has the right for it to be repaid within 12 months if it wishes. These are low risk assets where the possibility of a loss of principal or investment income is small.

Non Specified Investments

13.9 Non-specified investments are any other type of investment i.e. not defined as Specified above, and would include any sterling investments. The use of longer term instruments (greater than one year from inception to repayment) will fall in this category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the investment prudential indicator below.

13.10 The Council will only deal in the above investment types and the counterparties shown in Appendix 2 are those currently complying with our counterparty credit rating criteria (see above). Institutions will be added and removed in line with approval from the Deputy Chief Executive, as their criteria complies/does not comply with our credit rating criteria.

13.11 The most commonly used Non Specified Investments are:

- Supranational Bonds of more than one year duration
- Gilt Edged Securities
- The Councils own bankers if they fail to meet the basic credit criteria
- Any Deposits with an institution that meets the criteria above of more than one year duration

13.12 The Council's own bankers NatWest do not meet the banking criteria above but is included as part of the Eligible Institutions scheme.

13.13 **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties

13.14 In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

13.15 The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

13.16 **Economic Investment Considerations** - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat until 2015-16. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

13.17 The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Deputy Chief Executive may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

13.18 Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMDAF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria have been amended to reflect these facilities.

13.19 Provided that the institution passes the above criteria and is an approved counterparty. The Council has set the following monetary and time limits for any transactions. If they have been amended then the previous limits are shown in brackets.

	Maximum Money Limit	Maximum Time Limit
Gov't Part Owned Counterparty	£5m	6 Yrs
Other Approved Counterparty	£3m	6 Yrs
Group Limit	£6m	6 Yrs
Non UK Country Limit - New Limit	£6m	6 Yrs
SIBA see 13.20	£12m	
Money Market Funds	£5m Per Fund	
Enhanced Money Market Funds - See 13.21	£5m Per Fund	
Property Funds - See 13.21	£5m	
Debt Management Office	£Unlimited	6 Mths
Local Authorities	£5m Per Authority	6 Yrs

These limits will be monitored regularly to reflect any changes in market conditions and will be reported as appropriate.

13.20 Special Interest Bearing Account (SIBA) at NatWest - The SIBA is used as a call account for short term cash and is used on a day to day basis to keep surplus funds when it is not needed in the immediate short term but is not economical to lend out on the money markets. At certain times within the month, large amounts of funds are needed to make creditor payments and Precept payments to the County Council and Police authority, and so over a period, funds are built up in the SIBA to cover those transactions.

13.21 Both Enhanced Money Market Funds and Property Funds have been included for the first time to provide an alternative to longer term cash investments and will be explored further before any funds are committed.

14 EXTERNAL CASH FUND MANAGEMENT

14.1 Due to the relatively short time period that monies are available for investment and the relatively low levels of investment, the Council made a decision that Cash Management will be undertaken in house, rather than by external managers.

15 TREASURY MANAGEMENT LIMITS ON ACTIVITY

15.1 There are four further treasury activity limits, which were previously prudential indicators. 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 indicator 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. They have been set at the maximum level to allow for possible rescheduling opportunities into any period depending on market conditions.
- 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.

15.2 The Council is asked to approve the following limits:-

Interest Rate Exposure	2015/16	2016/17	2017/18
Limits On Fixed Interest Rates Based On Net Debt	100%	100%	100%
Limits On Variable Fixed Interest Rates Based On Net Debt	60%	60%	60%

Maturity Structure Of Fixed Interest Rate Borrowing 2014/1		
	Lower	Upper
Under 12 Months	0%	100%
12 Months To 2 Years	0%	100%
2 Years To 5 Years	0%	100%
5 Years To 10 Years	0%	100%
10 Years To 20 Years	0%	100%
20 Years To 30 Years	0%	100%
30 Years to 40 Years	0%	100%
40 Years To 50 Years	0%	100%
Over 50 Years	0%	100%

Maximum Principal Sums Invetsed > 365 Days	2015/16	2016/17	2017/18
Maximum Investment	£20m	£20m	£20m

16 PERFORMANCE INDICATORS

16.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report.

17 Treasury Management Advisers

17.1 The Council uses Capita Asset Services as its treasury management advisors. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;
- Training for Officers and Members

17.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.