Taunton Deane Borough Council

Full Council – 31 March 2015

Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy 2015/2016

Report of the Finance Manager
(This matter is the responsibility of Executive Councillor Williams – Leader of the Council)

1. Executive Summary

1.1 The purpose of this report is to explain and obtain approval of the recommended strategy for managing the Council's cash resources including the approach to borrowing and investments. It also seeks the formal approval of the Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy which must be approved by Full Council by 31 March each year in line with regulations.

1.2 The strategy has been prepared taking into account professional advice and information from the Council's treasury management advisor Arlingclose.

1.3 The strategy continues to prioritise security and liquidity of cash over investment returns. This year the strategy has been updated to reflect increasing treasury risks due to impact of the global economy on the financial sector and changes in regulations in respect of 'bail in' by UK banks, as failing banks will no longer be 'bailed out' by Government. In short, our approach in response to this increased risk is to spread surplus funds through a wider range of investments and deposits and reduce the limits for amounts held with each institution.

1.4 The Council currently has external borrowing of £92.2m, which is all attributable to the Housing Revenue Account.

1.5 The Council's investment balances fluctuate and currently range between £29m and £40m.

1.6 The Bank Base Rate has remained at 0.5% for several years and is currently forecast to remain at this level until mid-2015.

2. Background Information

2.1 The full Treasury Management Strategy Statement (TMSS), Annual Investment Strategy (AIS) and Minimum Revenue Provision (MRP) Policy are attached to this report. Due to the nature of the subject, and also in order to comply with both legislative and policy requirements, the documents contain a significant amount of technical detail and data.

2.2 The TMSS and related policies have been prepared taking into account the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the Code") and CLG Guidance on Local Government Investments ("the Guidance"). The TMSS for 2015/16 financial year must be approved by 31 March 2015.

2.3 The key principles of the Code are as follows:

- Ensuring that public bodies put in place the necessary framework to ensure the effective management and control of treasury management activities;

- That the framework clearly states that responsibility for treasury management lies clearly within the organisation and that the strategy clearly states the appetite for risk;

- That value for money and suitable performance measures should be reflected in the framework.

2.4 The Code also identifies four clauses to be adopted and these are as follows:

- The creation and maintenance of a policy statement and suitable treasury management practices which set out the means of achieving the policies and ensuring management and control.

- The minimum reports (to the body that approves the budget) should be an annual strategy and plan prior to the start of the financial year, a mid-year review and an annual report after its close. A local authority should ensure that its' reporting enables those responsible for treasury management to effectively discharge their duties.

- Details of delegated responsibility for implementation and monitoring of policies and for the execution and administration of treasury management decisions. For this Council the delegated person is the Section 151 Officer.

- Details of the body responsible for the scrutiny of treasury management strategy and policies. For this Council the delegated body is the Audit Committee.

2.5 The Council's finance officers have worked closely with Arlingclose, our treasury advisor, to consider the requirements of the Code and Guidance and determine the proposed TMSS, AIS and MRP Policy that ensure compliance and provide a set of 'rules' for the Council to following in dealing with investments, borrowing and cash flow management.

2.6 The current core principles remain in place within the proposed TMSS for 2015/16, which is to prioritise security (avoiding loss of council funds) and liquidity (quick access to cash) over return (interest costs and income).

2.7 However the TMSS for 2015/16 also recognises the increasing risks due to the new regulations in respect of ‘bail in’ for banks – explained in the TMSS. In response to this risk and the wider ongoing risks in the financial sector the treasury strategy has been updated to build in greater “diversification” – so that we will hold surplus funds in a wider range of investments/accounts i.e. we are spreading the risk. Table 2 within the TMSS sets this out is a useful summary.

3. Treasury Management Strategy Statement

3.1 Council approves the strategy in advance of the new financial year (this was introduced in 2010) and receives annual and mid-year reports, in accordance with the code.

3.2 This strategy is written in continuing challenging and uncertain economic times. The current economic outlook has a several key treasury management implications

- Investment returns are likely to remain relatively low during 2015/16
- Borrowing interest rates are currently attractive but are likely to remain low for some time
- The timing of any borrowing will need to be monitored carefully; there will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.3 This strategy looks to reduce exposure to risk and volatility at this time of significant economic uncertainty by

- Considering security, liquidity and yield, in that order
- Considering alternative assessments of credit strength
- Spreading investments over a range of approved counterparties
- Only investing for longer periods to gain higher rates of return where there are acceptable levels of counterparty risk.

3.4 The historically low interest rate situation has led to significant reductions in investment income in the past years which impacts directly on the Council’s budget.

3.5 The Council’s general fund capital financing requirement (CFR) for 2015/16 is £9.243m which is currently funded through internal borrowing. The council is able to borrow funds in excess of the current CFR up to the projected level in 2015/16 of £8.904m. The timing of any borrowing must be considered as mentioned in 3.1 above.

3.6 The Council’s Housing Revenue Account (HRA) CFR for 2015/16 is £108,251m which is currently funded through external borrowing of £92.198m plus internal borrowing of

£16,053m. The Government sets a debt cap for the HRA which currently limits borrowing to £115.8m.

3.7 Attached to this report is the recommended full Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy.

Scrutiny Comments

3.8 The content of this report has been presented to Corporate Scrutiny Committee on 26 March 2015. As the papers for this Council meeting are issued in advance of the Scrutiny meeting, a verbal update will be provided at Council in respect of any comments and/or recommendations from the Committee.

4. Finance Comments

4.1 This is a finance report and there are no further comments to make.

5. Legal Comments

5.1 There are no legal implications of this report.

6. Links to Corporate Aims

6.1 The TMSS supports the funding of projects as well as the general fund, which in turn support the Corporate Aims.

7. Environmental Implications

7.1 No environmental implications have been identified.

8. Community Safety Implications

8.1 No community safety implications have been identified.

9. Equalities Impact

9.1 After initial screening no Equality Impacts were identified for any specific group.

10. Risk Management

10.1 There are both credit and liquidity risk surrounding treasury activities. This strategy looks to minimise the Council's exposure to these risks.

11. Partnership Implications

11.1 No partnership implications have been identified.

12. Recommendations

12.1 That Full Council approves the 2015/16 Treasury Management Strategy Statement (TMSS) incorporating the Annual Investment Strategy, MRP Policy and Prudential Indicators.

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Taunton Deane Borough Council
Treasury Management Strategy Statement
and Annual Investment Strategy 2015/2016

Introduction

In February 2011 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services Code of Practice 2011 Edition (the "CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

The Council has borrowed and invested substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

External Context

Economic background: There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is currently extremely benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

The Monetary Policy Committee (MPC)'s focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings between August and December 2014, the minutes of the January meeting showed unanimity in maintaining the Bank Rate at 0.5% as there was sufficient risk that low inflation could become entrenched and the MPC became more concerned about the economic outlook.

Credit outlook: The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The *Bank Recovery and Resolution Directive* promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast *Deposit Guarantee Schemes Directive* includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, **the credit risk associated with making unsecured bank deposits will increase** relative to the risk of other investment options available to the Council.

Interest rate forecast: The Council's treasury management advisor Arlingclose forecasts the first rise in official interest rates in mid-2016 and a gradual pace of increases thereafter. The average for 2015/16 being around 0.50%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.0% and 3.5%. Arlingclose projects gilt yields on a modest upward path in the medium term, taking the forecast average 10 year PWLB loan rate for 2015/16 to 2.7%.

A more detailed economic and interest rate forecast provided by the Arlingclose is attached at ***Appendix A***.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.84%, and that new long-term loans will be borrowed at an average rate of 2.87%.

Local Context

The Council currently has £92.198m of borrowing and £34.935m of investments. This is set out in further detail at ***Appendix B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.14 Actual £'000	**31.3.15 Estimate £'000**	**31.3.16 Estimate £'000**	**31.3.17 Estimate £'000**	**31.3.18 Estimate £'000**
General Fund CFR	5,592	5,224	9,243	8,726	8,208
HRA CFR	97,798	97,287	108,521	107,514	105,086
Total CFR	**103,390**	**102,511**	**117,764**	**116,240**	**113,294**
Less: External borrowing	(94,198)	(92,198)	(108,860)	(106,162)	(102,162)
Internal borrowing	**9,192**	**10,313**	**8,904**	**10,078**	**11,132**
Less: Usable reserves	(28,366)	(25,546)	(28,451)	(32,653)	(36,319)
(Investments) or New borrowing	**(19,174)**	**(15,233)**	**(19,547)**	**(22,575)**	**(25,187)**

* shows only loans to which the Council is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

CIPFA’s *Prudential Code for Capital Finance in Local Authorities* recommends that the Council’s total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2015/16.

Borrowing Strategy

The Council currently holds £92.198m million of loans, as part of its strategy for funding previous years’ capital programmes. This sum increased significantly in March 2012 when the Council took on £82m of loans through the introduction of HRA Self Financing and the abolition of the old Housing Subsidy system. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £16.662m in 2015/16. The Council may, however, borrow to pre-fund future years’ requirements, providing this does not exceed the authorised limit for borrowing of £210 million.

The Council’s chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council’s long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Council’s borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2015/16 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and its successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Somerset Pension Fund)
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues
- UK local authorities

The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

LGA Bond Agency: Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the Council and used to bolster the Agency's capital strength instead. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

The Council holds £3m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The LOBO has an option during 2015/16, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Investment Strategy

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's average investment balance has ranged between £29 million and £41million, this is expected to reduce in 2015/16 as more of the Capital Programme is delivered.

Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2015/16. This is especially the case for the estimated £13m that is available for longer-term investment. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will therefore represent a substantial change in strategy over the coming year.

The Council may invest its surplus funds with any of the counterparties in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ unlimited 50 years	n/a	n/a
AAA	£2m 5 years	£4m 20 years	£4m 50 years	£2m 20 years	£1m 20 years
AA+	£2m 5 years	£4m 10 years	£4m 25 years	£2m 10 years	£1m 10 years
AA	£2m 4 years	£4m 5 years	£4m 15 years	£2m 5 years	£1m 10 years
AA-	£2m 3 years	£4m 4 years	£4m 10 years	£2m 4 years	£1m 10 years
A+	£2m 2 years	£4m 2 years	£2m 10 years	£2m 3 years	£1m 5 years
A	£2m 13 months	£4m 13 months	£2m 10 years	£2m 2 years	£1m 5 years
A-	£2m 6 months	£4m 6 months	£2m 10 years	£2m 13 months	£1m 5 years
BBB+	£500k 100 days	£1m 100 days	£1m 2 years	£1m 6 months	£500k 2 years
BBB or BBB-	£1m Next day only	£500k 100 days	n/a	n/a	n/a
Unrated			£4m 25 Years	£2m 10 Years	£1m 5 Years
Pooled funds	Up to 50% of total investments limited to £4m each fund				

This table must be read in conjunction with the notes below

Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standards and Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

In addition, the Council may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management advisor.

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Council's current account bank Nat West.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed. The Council will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

Pooled Funds: Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a fund manager in return for a fee. Money market funds offer same-day liquidity and aim for a constant net asset value, and will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Other Organisations: The Council may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management advisor.

Segregated Fund Manager: The Council could choose to use external fund managers. The manager has scope to add value through the use of the investments listed in table 2 and must operate within the same limits. Performance is monitored and measured against the benchmark set for the fund, prevailing economic conditions and investment opportunities.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. When an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. The Council does, on occasion, grant loans to small organisations for the purpose of furthering service provision within the Council's area but these loans fall outside of the scope of the Council's treasury management activities. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below BBB+	£10m
Total non-specified investments	£30m

Investment Limits: The Council's revenue reserves available to cover investment losses are forecast to be £25.546 million on 31st March 2015. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6.5 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts *(e.g. King & Shaxson)*, foreign countries and industry sectors as below:

Table 4: Investment Limits

	Cash limit
Any single organisation, including Supranational and Sovereign Agencies, except the UK Central Government and UK Local Authorities	£4m each

UK Central Government and UK Local Authorities	unlimited
Any group of organisations under the same ownership (Except UK Government)	£4m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign Banks (Excluding Supranational Organisations)	£4m per country
Registered Providers	£4m in total
Loans to unrated corporates	£2m in total
Money Market Funds	£20m in total

Approved Instruments: The Council may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the Council may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £4 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

Liquidity management: The Council uses a spreadsheet which details the Council's cash flow on a daily basis to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target
Portfolio average credit rating	A-

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target
Total cash available within 3 months	£6m

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2015/16	**2016/17**	**2017/18**
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
50 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2015/16	**2016/17**	**2017/18**
Limit on principal invested beyond year end	£30m	£30m	£30m

Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

Policy on Use of Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Policy on Apportioning Interest to the HRA: On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured at the end of the year and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Investment Training: The needs of the Council's treasury management staff for training in investment management are assessed every six months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

Investment Advisors: The Council has appointed Arlingclose Limited as treasury management advisors and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by holding quarterly meetings and tendering periodically. The last tender was completed in March 2013.

Investment of Money Borrowed in Advance of Need: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £220 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Financial Implications

The budget for investment income in 2015/16 is £366,800 (General Fund = £314,000, HRA = £52,800), based on an average investment portfolio of £25 million at an interest rate of 1.351%. The budget for debt interest paid in 2015/16 is £2.831 million (All HRA), based on an average debt portfolio of £96.3 million at an average interest rate of 2.80%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Operations (S151 Officer), believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however, long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment

		income in the medium term but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however, long-term interest costs will be less certain

Appendix A

Arlingclose Economic & Interest Rate Forecast February 2015

Underlying assumptions

- The UK economic recovery slowed towards the end of 2014 as economic and political uncertainty weighed on business investment. The Q4 growth rate of 0.5% was a little below the long run average, but more recent data suggests the recovery remains on track.

- Fiscal austerity and weak global growth are likely to weigh on the GDP growth contributions from government spending and net trade. With the UK General Election and possible EU referendum as major events in 2015 and (possibly) 2016, political uncertainty may continue to dampen business investment.

- Household consumption is therefore key to the recovery in 2015. The rise in employment, recovery in real wage growth, low interest rates and increase in disposable income should support spending at relatively robust levels.

- Inflationary pressure is currently low (annual CPI is currently 0.5%) and is likely to remain so in the short-term; we expect the CPI rate to fall further. Weak global growth expectations are likely to weigh on commodity price growth throughout this year, although there may be some recovery in the oil price over the forecast period.

- The MPC's focus is both the degree and rate of use of spare capacity in the economy, and the possibility of earnings-led inflationary pressure. The Committee will look through the effects of the fall in oil prices on inflation, as long as these are deemed temporary. A key measure is therefore the core CPI rate, which excludes food and energy, to establish the effect of domestic activity on inflationary pressure.

- Nominal earnings growth is strengthening, but remains relatively weak despite large falls in unemployment. Our view is that spare capacity remains extensive, allowing more rapid economic growth without an upward impact on inflation.

- In addition to the current lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone (and the wider global environment). The ECB has introduced outright QE. While this may alleviate some of the anxiety about the economic potential of the Eurozone, political risk remains significant. These factors will maintain the dovish stance of the MPC in the medium term.

- The appropriate level for Bank Rate for the post-crisis UK economy is likely to be lower than the previous norm. We would suggest this is between 2.0 and 3.0%.

Forecast

- Due to the outlook for lower inflation, we have pushed back our expectation for the first rise in official interest rates to Q2 2016. The risks to this forecast remain weighted to the downside; in particular, signs of more widespread deflation could prompt a further downward revision to our forecast.

- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited.

- We project gilt yields on an shallow upward path in the medium term, with continuing concerns about the Eurozone.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**
Downside risk			0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25
3-month LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.55	0.55
Arlingclose Central Case	**0.55**	**0.55**	**0.55**	**0.55**	**0.60**	**0.80**	**0.95**	**1.05**	**1.15**	**1.30**	**1.40**	**1.55**	**1.60**
Downside risk	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	1.05	1.10	1.25	1.35	1.35
1-yr LIBID rate													
Upside risk	0.10	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.45	0.60	0.60
Arlingclose Central Case	**0.95**	**0.90**	**0.95**	**1.00**	**1.05**	**1.25**	**1.40**	**1.50**	**1.60**	**1.75**	**1.85**	**2.00**	**2.05**
Downside risk	0.15	0.15	0.25	0.35	0.50	0.60	0.70	0.80	1.00	1.05	1.20	1.30	1.30
5-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.75	0.75
Arlingclose Central Case	**1.10**	**1.15**	**1.20**	**1.25**	**1.30**	**1.45**	**1.55**	**1.65**	**1.75**	**1.90**	**2.00**	**2.10**	**2.20**
Downside risk	0.25	0.35	0.45	0.55	0.70	0.80	0.90	1.00	1.00	1.10	1.15	1.25	1.30
10-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.75	0.75
Arlingclose Central Case	**1.65**	**1.70**	**1.75**	**1.80**	**1.85**	**2.00**	**2.10**	**2.20**	**2.30**	**2.45**	**2.55**	**2.65**	**2.75**
Downside risk	0.25	0.35	0.45	0.55	0.70	0.80	0.90	1.00	1.00	1.10	1.15	1.25	1.30
20-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.75	0.75
Arlingclose Central Case	**2.25**	**2.25**	**2.25**	**2.35**	**2.40**	**2.45**	**2.50**	**2.60**	**2.70**	**2.80**	**2.90**	**3.00**	**3.10**
Downside risk	0.25	0.30	0.40	0.50	0.65	0.75	0.85	0.95	0.95	1.05	1.10	1.20	1.25
50-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.75	0.75
Arlingclose Central Case	**2.35**	**2.35**	**2.35**	**2.45**	**2.50**	**2.55**	**2.60**	**2.70**	**2.80**	**2.90**	**3.00**	**3.10**	**3.20**
Downside risk	0.25	0.25	0.35	0.45	0.60	0.70	0.80	0.90	0.90	1.00	1.05	1.15	1.20

Appendix B

Existing Investment and Debt Portfolio Position

	31/12/2015 **Actual Portfolio £m**	31/12/2015 **Average Rate %**
External Borrowing: PWLB - Fixed Rate	84,198	3.03%
PWLB – Variable Rate	5,000	0.54%
LOBO Loans	3,000	4.25%
Total External Borrowing	**92,198**	**2.80%**
Investments Short Term	32,820	0.78%
Net Debt	**59,378**	

Appendix C

Prudential Indicators 2015/16

1. Background

1.1 The Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

2. Estimates of Capital Expenditure

2.1 The Council's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Non-HRA	3,814	1,012	1,232	230
HRA	16,147	8,665	8,715	8,869
Total	**19,961**	**9,677**	**9,947**	**9,099**

2.2 Capital expenditure will be financed as follows:

Capital Financing	2014/15 Revised £'000	2015/16 Revised £'000	2015/16 Estimate £'000	2017/18 Estimate £'000
Capital Receipts	1,656	1,012	975	205
Government Grants	610	0	0	0
Revenue Contributions	17,190	8,665	8,972	8,894
Unsupported borrowing	505	0	0	0
Total	**19,961**	**9,677**	**9,947**	**9,099**

3. Capital Financing Requirement

3.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing.

Capital Financing Requirement	31.03.15 Revised £'000	31.03.16 Estimate £'000	31.03.17 Estimate £'000	31.03.18 Estimate £'000
General Fund	5,224	9,243	8,726	8,208
HRA	97,287	108,521	107,514	105,086
Total CFR	**102,511**	**117,764**	**116,240**	**113,294**

3.2 The CFR is forecast to increase during 2015/16 as the council supports significant capital investment in both the General Fund and HRA, and then to fall by £4,470m over the following two years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

4. Gross Debt and the Capital Financing Requirement

4.1 This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 The S151 officer reports that the Council had no difficulty meeting this requirement in 2014/15, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Debt	31.03.15 Revised £'000	31.03.16 Estimate £'000	31.03.17 Estimate £'000	31.03.18 Estimate £'000
Borrowing	92,198	108,860	106,162	102,162

4.3 Total debt is expected to remain below the CFR during the forecast period.

5. Operational Boundary for External Debt

5.1 The Operational Boundary is based on the Council's estimate of the most likely, i.e. prudent but not worst case scenario for external debt. The Operational Boundary links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring.

	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Operational Boundary for External Debt	200,000	200,000	200,000	200,000

6. Authorised Limit for External Debt

6.1 The Authorised Limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements. The HRA has a debt cap of £115.8m which is a figure set by Central Government.

	2014/15 Revised £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Authorised Limit for External Debt	220,000	220,000	220,000	220,000

7. Ratio of Financing Costs to Net Revenue Stream

7.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2014/15 Revised %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
General Fund	(2.49)	(2.38)	(2.35)	(2.38)
HRA	10.58	10.80	11.51	11.09
Total	**8.09**	**8.42**	**9.16**	**8.70**

8. Incremental Impact of Capital Investment Decisions

8.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £
Increase in Band D Council Tax	0.84	1.01	0.19
Increase in Average Weekly Housing Rents	0.92	0.93	0.89

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Council has adopted the principles of best practice. The Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice 2011 Edition in February 2011. The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

Appendix D

Annual Minimum Revenue Provision (MRP) Statement 2015/16

1. Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP) although there has been no statutory minimum set aside since 2008. The Local Government act 2003 requires the Council to have regard to the Department for Communities and Local Government Guidance on Minimum Revenue Provision (the DCLG guidance most recently issued in 2012.

2. The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

3. The CLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

4. For the financial year 2014/15, the Council determined to calculate MRP as follows:-

    - for supported borrowing, 4% on outstanding debt;
    - for unsupported borrowing based on asset life*;
    - for capital grants and contributions to third parties, 4% (or 1/25th) per year on a straight line basis.

** The basis of calculating MRP on unsupported borrowing has been amended slightly to provide greater flexibility whilst adopting the same principle: to say that this will be "based on asset life" rather than "debt associated with asset divided by the estimated useful life of the asset".*

5. It is proposed the above policy, as amended in 4 above, remains for 2015/16.