Appendix F

TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS

1.The CIPFA Treasury Management Code of Practice

1.1 The Treasury Management and Investment Strategy has been set in accordance with the CIPFA Treasury Management Code of Practice 2011 and the revised Prudential Code for Capital Finance 2011.

1.2 Reporting & Scrutiny

The Council's Treasury Management Strategy will be approved annually by the full Council. In addition there will be monitoring reports and regular review by councillors in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

This Council has adopted the following reporting arrangements in accordance with the requirements of the revised Code:

To Council/ Committee/ Officer	Area of Responsibility	Frequency
Full Council	Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Annually before the start of the year
Scrutiny Board	Scrutiny of treasury management strategy and performance	As decided by the Board
Executive Head of Governance and Logistics	Treasury Management Monitoring Reports	Quarterly
Service Manager (Finance)	Treasury Management Practices	Updated annually and as required

(1) The Council will create and maintain, as the cornerstones for effective treasury management:

- a treasury management strategy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

(2) The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

(3) The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year and an annual report to the Joint Governance Committee after its close. Information on Treasury Management activities will be included in budgetary control reports to all councillors.

(4) The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices, and for the execution and administration of treasury management decisions to the Section 151 Officer (Chief Financial Officer), who will act in accordance with the organisation's policy statement and TMPs and the Cipfa Codes of Practise for Treasury Management.

1.3 Prudential Code for Capital

The Prudential Code for Capital requires the Council to set Prudential Indicators for Treasury Management and Capital Expenditure. These are set out at the end of this document.

2. Treasury Management Strategy for 2016/17

2.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2.2 The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included in this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

2.3 The suggested strategy for 2016/17 is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

The strategy covers:

- the current treasury position and borrowing requirement (3)
- prospects for interest rates (4)
- framework for investment and borrowing decisions (5)
- creditworthiness policy and use of external service providers(6)
- proposals for the funding of capital expenditure (7)
- the investment strategy (8)
- the lending list (9)
- treasury limits and prudential indicators (10)

2.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2.5 The Council will investigate the use of Municipal bonds as a way of gaining returns on short term cash surpluses and as a way of raising long term capital finance. If they are found to be beneficial these will be added to the borrowing and lending list in consultation with the Section 151 Officer.

3. Current Portfolio Position

The Council, in line with the approved business case, borrowed £4m in March 2012 from the Public Works Loans Board to support funding the construction of the Plaza. Other than that, the Council intends to borrow money only exceptionally to meet short term cash-flow needs in 2016/2017, unless there was a particularly attractive borrowing opportunity for financing the costs of vehicles and disabled facilities grants.

It is important to note that borrowing to 'on-lend' is illegal, and the Council will not engage in such activity. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

The Council currently has no long term investment deposits.

4. Prospects for Interest Rates

The Council has appointed Capita Asset Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. The budget for interest has been based on an estimate of approximately 0.5%. Capita have advised that, in their view, no interest rate rises will occur in 2016 and marginal increases in base rate toward the end of 2017. This view is supported by forecasts obtained from Tradition brokers, who anticipate no base rate increases for at least 2 years.

Capita Bank Rate forecast for financial year ends (March)

- 2016/17 0.5%
- 2017/18 1%

However, any forecasts beyond a one year time horizon will increasingly be subject to being significantly amended as and when world events and financial markets change. The forecasts of interest rates will be continually reviewed so that forward projections reflect a reasonable current view of investment returns.

5. Framework for investment and borrowing decisions

The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Council's investment priorities are:

(a) the security of capital and
(b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

The Council intends to balance risk and investment return but will continue to invest only in the highest rated institutions mainly through short term investments. This will involve constantly monitoring short term interest rate expectations to achieve investments at the optimum rates.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

The Council does not currently employ external fund managers and takes the view that the appointment of external fund managers would not justify the investment of senior management time in terms of the possible marginal return over what could be achieved internally or the possible greater risks involved.

There are currently no innovative financing or Private Finance Initiative schemes proposed. Any such schemes will be considered in full by the Cabinet and full Council as appropriate.

6. Creditworthiness Policy

This Council uses the creditworthiness service provided by Capita Asset Services. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors - forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

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

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a good level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service, though, does use ratings from all three agencies, but by using a scoring system, does not give undue weighting to just one agency's ratings.

All credit ratings will be monitored weekly but officers will also consider the information provided when the Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

7. Proposals for the funding of capital expenditure

Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision determined under Guidance.

The Council applies the Asset Life method in that guidance which makes provision over the estimated life of the asset for which the borrowing is undertaken on an equal instalment method. For any large acquisitions of land or buildings the annuity method may be used at the discretion of the Section 151 Officer. The first instalment of repayment of debt shall commence in the financial year following the one in which the expenditure is incurred. Where, for any reason, debt is outstanding on an asset which either no longer exists or has significantly reduced in value consideration shall be given to a voluntary repayment of debt.

Estimated life periods will be determined by the Section 151 Officer under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. Debt related to disabled facilities grants will be repaid over 20 years. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

8. Investment strategy

It will be the function of Treasury Management staff to calculate from cash flow forecasts the extent of any surplus cash available for investment and the periods for which funds can prudently be invested. Subject only to any specially negotiated banking terms, there will be no requirement for the authority to maintain a surplus cash balance in the bank account although such surpluses may occur from time to time. The intention should always be to maintain a nil cleared balance in the day to day accounts as far as possible. Cash may be placed in a higher interest account with the Council’s bankers, because the rate is competitive with investment rates, but subject to the total amount outstanding not exceeding £5 million, in accordance with the credit rating of that institution. Surplus cash may be invested in any of the following:

(i) UK clearing banks (and wholly owned subsidiaries where the repayment is guaranteed by a parent bank with the appropriate ratings indicated below)

(ii) Nationalised banks

(iii) Building Societies

(iv) Non-UK deposit taking banks

(v) Local Authorities

(vi) Gilts

(vii) Euro-Sterling bonds

(viii) Government Debt Management Office

In the case of (i), (ii) and (iii) above money may only be invested in accordance with Sector's weekly lists and the following credit criteria:

Category[1]	Maximum period to maturity	Maximum investment in one institution (or group)
Purple, Blue, Orange	364 days	£5 million
Red	6 months	£5 million
Green	100 days	£3 million
No colour – not to be used		

Investments with foreign banks shall only be made in the Purple category and the investment must be discussed with the Section 151 Officer (or in their absence the Service Manager (Finance)) prior to investment if the bank is not on a current list of qualifying foreign banks already agreed in writing with him/her.

For the purpose of the government investment guidance all investments of the types in (i) – (v) and (viii) above denominated in sterling meeting the credit criteria above shall be "specified investments".

It shall be a requirement in relation to (i), (ii), (iii) and (iv) that investment should not be made in an institution where it could be expected, at the time of investment, that the amount invested with that institution would at any time exceed 50% of the total Council investments – unless the total investments are below £4 million and with the agreement of the Section 151 Officer. Investment in all institutions must be subject to consideration of the credit rating prior to investment.

Any other type of "non-specified" investment must be agreed with the Cabinet, with professional investment advice as appropriate.

The Council uses the Sector credit rating system. The approved list of counter-parties must be amended immediately if any change occurs.

The Council may arrange investments through **approved brokers**, currently:

Tradition UK, Martin Brokers, Sterling International

or through formal **direct dealing relationships** as authorised by the S151 Officer, currently:

Lloyds Bank PLC, HSBC Bank PLC, Nationwide Building Society, UK National Debt Management Office, taking current ratings into account at all times. Institutions authorised but currently below the required rating: Barclays bank PLC, Bank of Ireland, Allied Irish Bank, Santander UK, Clydesdale Bank.

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[1] Where the Sector list includes suggested duration, suggested duration (watch/outlook adjusted) and suggested duration (CDS adjusted) the lowest category colour indicated will be used.

A list of **approved investment banks and building societies** created on the agreed criteria follows at the end of this report.

The Authority may appoint Specialist Fund Managers. Where such an appointment is made these criteria shall not apply and the basis of the investment strategy shall be agreed separately by the Cabinet in accordance with a formal agreement with the Fund Managers.

The Council maintains an **overdraft limit** of £250,000. Cashflow is monitored daily to ensure sufficient liquidity while achieving the best possible return and that use of the overdraft facility is minimised.

9. The Lending List

The Council's Lending List is under continual review and therefore the list is subject to change through the year in response to Sector rating changes. Any amendments are agreed with the S151 Officer. The approach to the Lending List is risk averse, and is intended to minimise default risk while maintaining flexibility.

10. Treasury Limits and Prudential Indicators for 2014/15 to 2018/19

Prudential and Treasury Indicators (as set out in the table attached to this report) are relevant for the purposes of setting an integrated treasury management strategy.

It is a statutory duty under Section 3 of the Local Government Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in this report.

The Section 151 Officer is to have authority, within the total limits for External Debt and Operational Boundary, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Any such changes made will be reported to the Council at its next meeting following the change.

In considering the capital programme the Council has had regard to the following factors as required by the Prudential Code:

- Affordability eg implications for the Council Tax
- Prudence and sustainability
- Value for money
- Stewardship of assets
- Service objectives
- Practicality and achievability

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PRUDENTIAL CODE INDICATORS	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000s	**£000s**	**£000s**	**£000s**	**£000s**
Estimate of capital expenditure	1,707	2,752	3,133	1,100	1,100
Ratio of financing costs to net revenue stream - compares the total principal and net external interest to the overall revenue spending of the authority	6.06%	5.28%	5.68%	4.80%	4.36%
Net external borrowing 31 March:					
brought forward 1 April	-3,805	-3,702	-3,595	-3,484	3,368
carried forward 31 March	-3,702	-3,595	-3,484	-3,368	-3,247
Estimated capital financing requirement at 31 March	12,093	12,187	12,551	12,463	12,447
Annual change in Capital Financing Requirement	175	94	364	-88	-16
Estimate of the incremental impact of capital investment decisions on the Council Tax at Band D	£1.25	£1.57	£1.72	£1.86	£2.00
Is net external borrowing at 31 March greater than Capital Financing Requirements?	No	No	No	No	No
Treasury Management Indicators					
Authorised limit for external debt - borrowing	10,000	10,000	10,000	10,000	10,000
Authorised limit for external debt - other long term liabilities	500	500	500	500	500
Operational boundary for external debt -maximum level of external debt taking into account capital expenditure and financing plans	8,000	8,000	8,000	8,000	8,000
Operational boundary -other long term liabilities	300	300	300	300	300
Interest rate exposures:					
Upper limit on fixed interest net borrowing	100%	100%	100%	100%	100%
Upper limit on variable interest net borrowing	100%	100%	100%	100%	100%
Upper limit for principal sums invested for periods longer than 364 days	2,000	2,000	2,000	2,000	2,000

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Maturity structure of fixed rate borrowing in each of the next three years:		Upper limit	Lower Limit		
Under 12 months		100%	0%		
1-2 years		100%	0%		
2-5 years		100%	0%		
5-10 years		100%	0%		
Over 10 years		100%	0%		

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Borrowing and Lending List 2016/17

<u>APPROVED INVESTMENTS LIST – BANKS AND BUILDING SOCIETIES</u>

Sector Credit Rating (lower of suggested duration or with subjective overlay)	**Institution**	**Maximum duration**	**Maximum amount* *Limit applies to group as well as individually**
	RBS Group		
Blue	Royal Bank of Scotland	364 days	£5 million or half of total investments at any time whichever is lower.
Blue	National Westminster Bank	364 days	£5 million or half of total investments at any time whichever is lower* see note below
	Lloyds Group		
Blue	Bank of Scotland	364 days	£5 million or half of total investments at any time whichever is lower.
Blue	Lloyds Bank	364 days	£5 million or half of total investments at any time whichever is lower.
	Other Institutions		
Orange	HSBC Bank	364 days	£5 million or half of total investments at any time whichever is lower.
Red	Standard Chartered Bank	6 months	£5 million or half of total investments at any time whichever is lower.
Red	Barclays	6 months	£5 million or half of total investments at any time whichever is lower.
Red	Santander	6 months	£5 million or half of total investments at any time whichever is lower.
Green	Close Brothers	100 days	£3 million or half of total investments at any time whichever is lower.
	Building Societies		
	Nationwide Building Society	100 days	£3 million or half of total investments at any time whichever is lower.
	Coventry Building Society	100 days	£3 million or half of total investments at any time whichever is lower.
	Leeds Building Society	100 days	£3 million or half of total investments at any time whichever is lower.

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Supplementary to the above, investments may be placed under the following criteria:

NatWest Call Account - Up to £5 million may be invested in the National Westminster SIBA account subject to the group maximum and the 50% rule (BLUE rated)

Central Government - Unlimited investments may be placed in the government's Debt Management Office

Local Authorities - Up to £5 million may be invested with any other Local Authority subject to the group maximum and 50% rule (assuming a RED rating for all LAs)

Foreign Banks that meet the purple criteria: NO INVESTMENT IS CURRENTLY UNDERTAKEN WITH FOREIGN BANKS.