

## **TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2015/16**

### **1 SUMMARY**

- 1.1 This report sets out the Council's Treasury Management Strategy for borrowing and investment for 2015/16 and seeks the views of the Review Committee on the approach proposed in this Strategy, before it is presented for approval by Full Council on 24 February 2015.
- 1.2 Under The Prudential Code for Capital Finance in Local Authorities, there is a requirement for this report, the Mid Year Treasury Management report, and the Annual Treasury Report to be scrutinised before it goes to Council.
- 1.3 Treasury management is defined as:-
- “The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. ”
- 1.4 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 1.5 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

### **2 INTRODUCTION**

- 2.1 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are:-
- The Prudential and Treasury Indicators and Treasury Strategy (this report), which covers:-
    - the capital plans (including prudential indicators);

- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
  - an investment strategy (the parameters on how investments are to be managed).
- The Mid Year Treasury Management Report which will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the Treasury Strategy is delivering its objectives or whether any policies require revision. In addition, the Executive will receive quarterly updates of the capital programme position.
  - Annual Strategy report (reported to Council in June). This provides details of actual performance compared to the estimates.
  - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Review Committee.
- 2.2 The suggested Strategy for 2015/16, in respect of the following aspects of the treasury management function, is based upon the Head of Finance's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor.
- 2.3 The Strategy covers:-
- Capital Issues**
- The capital plans and the prudential indicators;
  - The Minimum Revenue Provision (MRP) Strategy;
- Treasury Management Issues**
- Treasury indicators which will limit the treasury risk and activities of the Council;
  - The current treasury position;
  - The borrowing strategy;
  - Prospects for interest rates;
  - Policy on borrowing in advance of need;
  - The investment strategy;
  - Creditworthiness policy; and
  - Policy on use of external service providers.
- 2.4 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

2.5 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Comprehensive training was provided by our Relationship Manager at Capita Asset Services on 16 October 2014 and further training will be arranged as required.

2.6 The Council uses Capita Asset Services “Capita” (formerly Sector Treasury Services) as its external treasury management advisors.

### **3 CAPITAL PRUDENTIAL INDICATORS FOR 2015/16 TO 2017/18**

3.1 The Council’s capital expenditure plans are the key driver of treasury management activity. The capital expenditure plans are reflected in prudential indicators, which are designed to assist Members’ overview and confirm capital expenditure plans.

3.2 **Capital Expenditure.** This prudential Indicator is a summary of the Council’s capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The table below also shows how these plans are being financed and any shortfall that will require borrowing.

<b>£000s</b>	<b>2013/14 Actual</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
Capital Expenditure	1,289	1,630	3,737	1,007	666
<b>Financed by:</b>					
Capital receipts	760	856	1,781	300	250
Capital grants	190	423	150	150	150
Minimum Revenue Provision (Waste & Street Cleansing Vehicles)	339	351	-	-	-
<b>Net financing need for the year</b>	-	-	1,806	557	266

3.3 The Council’s Borrowing Need (the Capital Financing Requirement - CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The CFR is reduced by the application of resources such as capital receipts, grants or charges to revenue. It is also reduced by the application of Minimum Revenue Provision charges to revenue.

3.4 Following accounting changes arising from the implementation of International Financial Reporting Standards, elements of some of our outsourced contracts, e.g. Recycling, now have to be treated as Finance Leases and brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council’s

borrowing requirement, these types of scheme in effect include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.35m of such schemes within the CFR, but these come to an end in April 2015.

3.5 The current CFR projections are in the table below:-

£000s	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
CFR	1,061	1,061	2,867	3,424	3,690
<b>Movement in CFR</b>	-	-	<b>1,806</b>	<b>557</b>	<b>266</b>

#### **4 Minimum Revenue Provision (MRP) Policy Statement**

- 4.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
- 4.2 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.
- 4.3 There is an historic adjustment arising from the former Housing Revenue Account which results in a negative CFR for the purposes of the MRP calculation.
- 4.4 Annual repayments in respect of finance leases arising from outsourced contracts are applied as MRP.

#### **5 OTHER INDICATORS**

##### **The Use of the Council's Resources and the Investment Position**

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going 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 £000s	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Fund balances / reserves	3,163	2,760	3,580	4,820	6,130
Capital receipts	2,092	1,550	-	-	-
<b>Total core funds</b>	<b>5,255</b>	<b>4,930</b>	<b>3,437</b>	<b>3,802</b>	<b>4,225</b>
Working capital*	50	50	50	50	50

<b>Expected investments</b>	<b>2,014</b>	<b>1,500</b>	<b>1,500</b>	<b>2,000</b>	<b>2,500</b>
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\*Due to the balances that make up working capital being unpredictable, the estimates for future years have been kept static at the 2013/14 actual figure.

### **Affordability Prudential Indicators**

- 5.1 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.
- 5.2 The indicators are designed to support and record local decision making in a manner that is publicly accountable and are not designed to be comparative performance indicators to other organisations. There are no recommended limits or values for the indicators.
- 5.3 These provide an indication of the impact of the capital investment plans on the Council's overall finances. Members are asked to approve the following indicators.
- 5.4 **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.

<b>%</b>	<b>2013/14 Actual</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
Ratio of Financing Costs to Net Revenue Stream	(0.36%)	(0.60%)	(0.22%)	0.06%	0.26%

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

- 5.5 **Incremental impact of capital investment decisions on the band D council tax.** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this strategy compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support:

<b>£</b>	<b>2013/14 Actual</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
<b>Council tax - band D</b>	(0.18)	0.12	1.00	0.09	(0.02)

## **6 TREASURY MANAGEMENT STRATEGY**

### **BORROWING**

- 6.1 The capital expenditure plans set out in Section 3 provide details of the capital investment activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.
- 6.2 The Council's treasury portfolio position at 31 March 2014 with forward projections is shown below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing:-

	<b>2013/14 Actual</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
<b>Borrowing</b>	-	-	1,806	2,363	2,629
<b>Capital Financing Requirement</b>	1,061	1,061	2,867	3,424	3,690

- 6.3 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. As there is no borrowing, the Chief Finance Officer can report 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 report.

### **TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY**

- 6.4 **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.
- 6.5 The Operational Boundary reflects the most likely (not worst case scenario), and should be a prudent view of the level of gross external indebtedness (borrowing + long term liabilities). It is regularly monitored and any breaches would be investigated promptly.

<b>Operational boundary £000s</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
<b>Debt</b>	-	1,806	2,363	2,629

- 6.6 **The Authorised Limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents the upper limit beyond which external debt is prohibited, and this limit can only be revised by the full Council. It reflects the level of external debt which could be afforded in the short term, but is not sustainable in the longer term and provides headroom over and above the operational boundary which should be sufficient for unusual cash limits.
- 6.7 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
- 6.8 The Authorised and Operational limits are based on the assumption that there will be long term borrowing to fund capital expenditure and that borrowing will be to fund long and short term cash flow requirements. The limits include balance sheet liabilities such as finance leases and creditors.

<b>Authorised limit £000s</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
<b>Debt</b>	6,400	9,500	9,500	9,500

## **7 PROSPECTS FOR INTEREST RATES**

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

<b>Annual Average Forecast Rates (%)</b>				
<b>Year</b>	<b>Bank Rate</b>	<b>PWLB Borrowing</b>		
		<b>5 Year</b>	<b>25 Year</b>	<b>50 Year</b>
2014/2015	0.50	2.20	3.40	3.40
2015/2016	0.75	2.40	3.80	3.80
2016/2017	1.25	3.00	4.40	4.40
2017/2018	1.75	3.50	4.70	4.70

- 7.2 Until 2013, the economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history. However, growth rebounded during 2013 and especially during 2014, propelled mainly by recovery in consumer spending and the housing market. Future growth surveys are very positive

with strong growth expected in 2015, particularly in the services and construction sectors. However, growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent.

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

- The downturn in growth and inflation during the second half of 2014, worries over the Ukraine situation, Middle East, Ebola and oil prices have led to a resurgence of concerns that the Eurozone could be heading into deflation and a triple dip recession since 2008.
- 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 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 even higher borrowing costs, where financing will be required;
- However, for any borrowing there will be a cost to carry as any increase in investments will incur a loss between borrowing costs and investment returns.

## **8 BORROWING STRATEGY**

8.1 The Council's borrowing requirement for the period 2015/16 to 2017/18 is currently forecast to increase as follows:

	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
<b>Borrowing</b>	1,806	2,363	2,629

8.2 The level of receipts available for funding the capital programme is set to run out, and therefore a review of assets has been carried out and a disposal strategy approved by The Executive. If the required sales are not fulfilled, then borrowing will be the only way in which the programme can be financed.

8.3 The Section 151 Officer decides on the most appropriate method of financing the Capital Programme. In the current economic environment with low interest rates, it may be more cost effective to finance capital expenditure by external borrowing but this will be on the advice of our treasury management advisors and will be reported to Members if this action is considered further.



- 8.4 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.
- 8.5 Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:-
- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed.*
  - *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.*
- 8.6 Any decisions will be reported to Members at the earliest available opportunity.
- 8.7 The current strategy of this Authority is to avoid borrowing whilst it is not considered necessary. Should the need for borrowing be envisaged, then borrowing may be undertaken earlier if interest rates are advantageous.

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

- 8.8 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:-
- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
  - Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

8.9 The limit indicators are shown separately for borrowing and investments. Fixed rates for investments or borrowing for a period of less than one year are treated as variable by the Prudential Code.

<b>Interest rate Exposures £000s</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates:</b>			
<b>Borrowing</b>	9,500	9,500	9,500
<b>Investments</b>	3,000	3,000	3,000
<b>Limits on variable interest rates:</b>			
<b>Borrowing</b>	3,100	3,100	3,100
<b>Investment</b>	8,500	9,000	9,500

<b>Maturity Structure of fixed interest rate borrowing during 2015/16</b>		
	<b>Lower</b>	<b>Upper</b>
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 and above	0%	100%
<b>Maturity Structure of variable interest rate borrowing during 2015/16</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	100%
12 months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above	0%	0%

## **9 POLICY ON BORROWING IN ADVANCE OF NEED**

9.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision

to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

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

- ensure the on-going 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;
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

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

## **10 LOCAL CAPITAL FINANCE COMPANY LIMITED**

10.1 The Council is participating in the creation of a local authority Municipal Bond Agency (MBA) which will issue bonds and then on lend to local authorities. The objective is to obtain lower borrowing rates than available from Public Works Loan Board (PWLb). The Council's contribution to the set up costs (estimated at £10k) will be treated as an investment as the Council is a shareholder.

10.2 Any decision to borrow via the MBA will be based on an evaluation of the costs and terms compared to the PWLB and any other options that might be available.

## **11 ANNUAL INVESTMENT STRATEGY**

11.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

11.2 It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment,

merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

- 11.3 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.
- 11.4 Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

### **Investment Policy**

- 11.5 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") 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 will be security first, liquidity second, then return.
- 11.6 In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Capita ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
- 11.7 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Capita, in producing its colour codings which show the varying degrees of suggested creditworthiness.

- 11.8 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- 11.9 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.
- 11.10 The intention of the strategy is to provide security of investment and minimisation of risk.
- 11.11 The specified Investment instruments identified for use in 2015/16 are listed below:-
- Debt Management Agency Deposit Facility (Government Managed)
  - Term deposits – UK government
  - Term deposits – other Local Authorities
  - Term deposits – banks and building societies
  - Money Market Funds
  - Treasury Bills
  - Certificates of Deposit
- 11.12 Counterparty limits will be as set through the Council's treasury management practices schedules.

### **Creditworthiness policy**

- 11.13 This Council applies the creditworthiness service provided by Capita. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, 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 Swaps (CDS) spreads to give early warning of likely changes in credit ratings,
  - Sovereign ratings to select counterparties from only the most creditworthy countries.
- 11.14 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments.

11.15 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions within Capita's weekly credit list of worldwide potential counterparties.

11.16 In order to minimise risk and maintain diversity, the Council will have a limit on the amount which can be placed in institution. This limit will also apply to groups. Because the value of investments held at any time can vary by up to £6m, depending on cash flow requirements, it is not considered practical to have a percentage limit. The limits will be linked to duration and be as follows:-

<b>Capita Colour Coding</b>	<b>Maximum Duration</b>	<b>Maximum Investment</b>
No colour	Not to be used	0
Green	100 days	£6m
Red	6 months 100 days	£3m £6m
Orange	1 year 6 months 100 days	£1m £3m £6m
Blue	1 year	£4m
Purple	2 years 100 days	£3m £6m

<b>Organisation</b>	<b>Maximum Duration</b>	<b>Maximum Investment</b>
Debt Management Office (Government Body)	3 months	£14m
Lloyds Bank current account The Council's main banker	On call (can be withdrawn immediately)	£3m
Money Market Funds – AAA long-term credit rating	On call (can be withdrawn immediately)	£3m per fund
Certificates of Deposit and Treasury Bills.	Will follow the Capita Colour Coding limits as per the above table.	Will follow the Capita Colour Coding limits as per the above table.
Local Authorities	1 year	£3m
Local Capital Finance Company Limited	10 years	£10,000 & 0.6% of borrowing

11.17 This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

- 11.18 All credit ratings will be monitored weekly and as new information comes to light. 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 Councils lending list.
- 11.19 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.
- 11.20 Property Funds – Officers will work with Capita to access whether investment in property funds would be an option. Progress on this will be included in the Mid Year review.

## **12 INVESTMENT STRATEGY**

### **Country Limits**

- 12.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).
- 12.2 All Countries other than the UK will be subject to a £3m investment limit for duration of up to one year.

### **Investment Management**

- 12.3 The Council does not use a fund manager and funds are managed in-house. Investments will accordingly be made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
- 12.4 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015/16. Bank Rate forecasts for financial year ends (March) are:-
- 2015/ 2016 0.75%
  - 2016/ 2017 1.25%

- 2017/ 2018 2.00%

12.5 There are upside risks to these forecasts (i.e. start of increases in Bank Rate occur sooner) if economic growth remains strong. However, should the pace of growth fall back there could be downside risk, particularly if Bank of England forecasts for unemployment prove too optimistic.

12.6 The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next three years are as follows:-

2015/16	0.55%
2016/17	1.00%
2017/18	1.50%

12.7 The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

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

### **13 POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS**

13.1 The Council uses Capita Asset Services as its external treasury management advisers.

13.2 The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers.

13.3 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.

### **14 SCHEME OF DELEGATION**

14.1 Under the Code, the Council is required to specify its Scheme of Delegation for Treasury Management and the responsibilities of the Section 151 Officer, and this is shown below:-

#### **(i) Council**

- receiving and reviewing reports on treasury management policies, practices and activities.



- approval of annual strategy.
- budget consideration and approval.
- receiving the end of year report on treasury management.

**(ii) Review Committee Treasury Management Task & Finish Group**

- scrutiny of the three main treasury reports, before recommendation to Council or Executive.

**(iii) Executive**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices.
- approval of the division of responsibilities.
- receiving and reviewing regular monitoring reports and acting on recommendations.

**(iv) Audit committee**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

**(v) Section 151 officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance.
- submitting regular treasury management policy reports.
- submitting budgets and budget variations.
- receiving and reviewing management information reports.
- reviewing the performance of the treasury management function.
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- ensuring the adequacy of internal audit, and liaising with external audit.
- approving the selection of external service providers and agreeing terms of appointment.

**15 RISK IMPLICATIONS**

- 15.1 It is necessary to outline the risks involved in the investments made by the Council. There is of course always a risk that a building society or bank may fail during the duration of an investment but this is considered less likely

where the institution has a minimum credit rating as specified in our Investment Strategy. Although the Government have provided assistance and guarantees where banks have encountered problems which have threatened their future, this cannot be guaranteed for the future.

- 15.2 With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. Therefore no investments for more than 1 year will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment.
- 15.3 The Council may use Money Market Funds from AAA-rated institutions for cash balances. These are funds with the highest credit rating, providing excellent security for the Council's money. Surplus balances not invested in pure cash deposits can earn a rate similar to 1 month London Interbank Bid Rate, and funds can be accessed with minimal notice. Returns are not fixed, however, and will rise and fall in line with the market. As a result, these funds will not be used to take a view on the likely future path of interest rates, or as a protection against falling rates. Their natural use is for balances too small to place with banks and building societies, or as an alternative to a bank call account.
- 15.4 The treasury management function cannot take place without an agreed Treasury Management Strategy in place before the start of the financial year.
- 15.5 Reputation Risk - The Council is responsible for managing the investment of public funds and must be seen to be adopting a pragmatic and prudent approach.

## **16 RESOURCE IMPLICATIONS**

- 16.1 All interest paid and received is accounted for within the General Fund. The amount of income generated is dependent upon interest rates and level of balances.

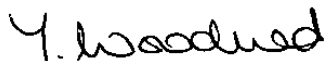
## **17 LEGAL IMPLICATIONS**

- 17.1 This strategy complies with the statutory requirements set out in the Local Government Act 2003 and associated guidance and regulations.

## **18 RECOMMENDATION**

- 18.1 It is proposed that the Committee **RESOLVES** to:-

- (1) Note the Treasury Management Strategy Statement and Annual Investment Strategy including the investments instruments, indicators, limits and delegations contained within the report.
- (2) Note the Capital Expenditure Forecasts.
- (3) Note the MRP policy for 2015/16.
- (4) Note the Authorised Limit and Operational Boundary for external debt as laid down in the report.
- (5) Identify any issues on this topic for further consideration and discussion by the Committee.
- (6) Recommend the contents of this report to Full Council.



Yvonne Woodward

Head of Finance

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**Background Papers:-**

None

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If you would like this report in large print, Braille or another language please contact 01702 318111.