

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement
and Annual Investment Strategy

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1 INTRODUCTION

1.1 Background

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

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 Reporting requirements

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

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to Full Council. This role is undertaken by the Corporate Governance and Finance Committee.

1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

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

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

2 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts: (note these include the loan financing of up to £5 million for the LATC, but no funding for the leisure centre project at this stage).

Capital expenditure £'000	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	2,242	2,776	3,232	490

Other long-term liabilities: the above financing need excludes other long term liabilities, such as the new leisure centre.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure £'000	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	2,242	2,776	3,232	490
Financed by:				
Capital grants	260	200	200	200
Capital reserves / receipts	1,414	289	261	261
Revenue	568	29	29	29
Net financing need for the year	0	2,258	2,742	0

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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

The CFR includes any other long term liabilities. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council is currently considering a scheme to develop a new district wide leisure facility and has also set up a Local Authority Trading Company. Approval of the leisure centre will require that the capital programme be adjusted to reflect the agreed spend and funding profile, but as reported previously, figures for this are not included in this paper.

The Council is asked to approve the CFR projections below:

£'000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Financing Requirement					
Total CFR	20	(2)	2,256	4,998	4,998
Movement in CFR	(84)	(22)	2,258	2,742	0

Movement in CFR represented by					
Net financing need for the year (above)	0	0	2,258	2,742	0
Less MRP/VRP and other financing movements	(84)	(22)	0	0	0
Movement in CFR	(84)	(22)	2,258	2,742	0

2.3 Minimum revenue provision (MRP) policy statement

In most cases, the Council is required to pay off an element of the accumulated 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).

CLG regulations have been issued which require 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. The Council is recommended to approve the following MRP Statement.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction)

These options provide for a reduction in the borrowing need over approximately the asset's life. Repayments included in annual finance leases are applied as MRP.

However, on this occasion, as the capital spend relates to a short-term loan arrangement to the LATC, the policy will be to not charge any MRP to the revenue account as the full repayment of the loan will be received from the LATC within five years.

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

Projected level of cash balances (at the end of each financial year) are set out below

£'000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Revenue Reserves	5,775	5,474	5,465	4,039	3,108
S106 / CIL	4,471	5,621	6,471	6,471	6,471
Capital Receipts reserves	1,863	539	865	1,709	1,478
Cash (Debtor / Creditors)	4,582	3,930	3,930	3,930	3,930
Internal borrowings	0	0	(2,256)	(4,998)	(4,998)
Total Investments	16,691	15,564	14,475	11,151	9,989
Movement in Year	2,608	(1,127)	(1,089)	(3,324)	(1,162)

In as much as the table shows the Council having funds to invest, this will gradually reduce over the years as the reserves and receipts are utilised, there are strong internal balances to fund the majority of capital costs from internal cash balances.

With the proposed leisure centre, some current assets will be disposed of, with the funds realised, then being expended towards the new leisure facility. The funding strategy for the leisure centre assumes capital receipts and Section 106 / CIL totalling £2.1 million will be used.

2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

2.6 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Net Revenue Budget	£8,552k	£8,209k	£9,056k	£9,284k
Ratio	(0.07)	(0.07)	(0.18)	(0.06)

The estimates of financing costs include current commitments and the proposals in this budget report, which does include the LATC funding interest payments on the loan.

2.7 Incremental impact of capital investment decisions on Council Tax

This indicator identifies the revenue costs associated with proposed changes to the capital programme recommended in this budget report 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.

Incremental impact of capital investment decisions on the band D council tax

£	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Council tax band D – tax base	28,263	28,682.1	29,107.4	29,539.1
Change in Council Tax – Band D	20p	19p	57p	20p

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the 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.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External Debt					
Debt at 1 April	0	0	0	0	0
Expected change in Debt	0	0	0	0	0
Other long-term liabilities (OLTL)	192	106	22	0	0
Expected change in OLTL	86	84	22	0	0
Actual gross debt at 31 March	106	22	0	0	0
The Capital Financing Requirement	20	(2)	2,256	4,998	4,998
Under / (over) borrowing	(86)	(24)	2,256	4,998	4,998

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

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

3.2 Treasury Indicators: limits to borrowing activity

The Operational boundary: This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Debt	0	0	0	0
Other long term liabilities	106	0	0	0
Total	106	0	0	0

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

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

Authorised limit £'000	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	106	0	0	0
Total	5,106	5,000	5,000	5,000

3.3 Prospects for interest rates

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

	NOW	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.50	1.50	1.50	1.75
3 month LIBID	0.52	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.10	1.30	1.30	1.60	1.80	1.90
6 month LIBID	0.66	0.70	0.70	0.70	0.80	0.90	1.00	1.20	1.40	1.60	1.70	1.80	2.00	2.20
12 month LIBID	0.98	1.00	1.00	1.00	1.10	1.20	1.30	1.50	1.70	1.90	2.00	2.10	2.30	2.40
5 year PWLB	1.55	1.70	1.90	2.00	2.10	2.20	2.30	2.40	2.60	2.70	2.80	2.90	3.00	3.10
10 year PWLB	2.20	2.30	2.40	2.50	2.60	2.70	2.80	2.90	3.00	3.10	3.30	3.40	3.50	3.60
25 year PWLB	3.05	3.20	3.20	3.30	3.30	3.50	3.50	3.60	3.60	3.70	3.70	3.70	3.80	3.80
50 year PWLB	2.88	3.00	3.00	3.10	3.10	3.30	3.30	3.40	3.40	3.50	3.60	3.60	3.70	3.70

UK. UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon.

However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 1% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now firmly opened up the possibility of a first rate rise in December.

EZ. In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
 - Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenomenally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
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- There will remain a cost of carry to any new borrowing which causes an increase in investments which will incur a revenue loss between borrowing costs and investment returns.

3.4 Capita Asset Services Forward View

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities in contrast to recent market activity which has seen FTSE100 drop to 5500 and gilt yields reach the lows last seen in 2013 and 2014.

We have pointed out consistently that the Fed. Rate is likely to go more quickly and more strongly than Bank Rate in the UK and recent events have not changed that view, just that the timing of such increases may well have been deferred until calmer waters are on the horizon. While there is normally a high degree of correlation between the two yields, we would expect to see a decoupling of yields between the two i.e. we would expect US yields to go up faster than UK yields. We will need to monitor this area closely and the resulting effect on PWLB rates.

The overall balance of risks to economic recovery in the UK remains to the downside. Although economic growth remains relatively steady, only time will tell whether some of the global headwinds sap some of the strength from the UK's future growth.

We would remind clients of just how unpredictable PWLB rates and bond yields are at present. We are experiencing exceptional levels of volatility which are highly correlated to emerging markets, geo-political and sovereign debt crisis developments. Our revised forecasts are based on the Certainty Rate (minus 20bps) which has been accessible to most authorities since 1st November 2012.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Emerging country economies, currencies and corporate destabilised by falling commodity prices and / or Fed. rate increases, causing a further flight to safe havens (bonds).
 - Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
 - UK economic growth and increases in inflation are weaker than we currently anticipate.
 - Weak growth or recession in the UK's main trading partners - the EU and US.
 - A resurgence of the Eurozone sovereign debt crisis.
 - Recapitalisation of European banks requiring more government financial support.
 - Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.
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The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

3.5 Borrowing Strategy

In using internal cash balances the Council will be in an under-borrowed position. There may be a need to borrow over the next three years, financing the LATC and Leisure centre

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Chief Finance 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, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *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 an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an 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 are still lower than they will be in the next few years.

There may be a need to borrow over the next three years, financing both the Leisure centre and the LATC will require a combination of long term and short term borrowing.

There will essentially be two funding options when the Council makes its decision>

- Raise funding externally : Interest rates are currently low but predicted to rise in the coming years. Any borrowing cost will exceed interest earned on cash investment.
- Alternatively the council could use the combination of both internal and external funding: by using core internal funds to finance the Leisure centre, with the leisure centre paying back the borrowed funds with interest to an agreed time frame.
- Therefore the most likely funding approach is to fund the LATC from external borrowing, at the point when internal cash balances are at prudent level.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

Treasury management limits on activity

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

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

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

£million	2016/17	2017/18	2018/19
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	25	25	25
Limits on variable interest rates based on net debt	25	25	25
Maturity structure of fixed interest rate borrowing 2016/17			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years to 20 years	0%	100%	
20 years to 30 years	0%	100%	
30 years to 40 years	0%	100%	
40 years to 50 years	0%	100%	
Maturity structure of variable interest rate borrowing 2016/17			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years to 20 years	0%	100%	
20 years to 30 years	0%	100%	
30 years to 40 years	0%	100%	
40 years to 50 years	0%	100%	

3.6 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

4 ANNUAL INVESTMENT STRATEGY

Introduction: changes to credit rating methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendix 5.3 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and Standard and Poor’s. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored **weekly**. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

4.3 Counterparty Limits

In order to place fixed term deposits, as set out in paragraph 1.3, extensions to the existing counterparty limits are requested.

It is recommended that a limit of:

- £6m with counterparties rated 6 months to 1 year (Orange) durational limit
- £5m with Money market Funds
- £4m with counterparties rated 3-months (green) durational limit on the approved weekly list

It is recommended that these counterparty limits apply with immediate effect (i.e. from the 26th February 2016).

4.4 Country and sector limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.5 Investment strategy

The council continues to hold cash balances and is able to meet the loan requirements of the LATC without recourse to external borrowing. The cashflow projection of the LATC enables the council to make investments in fixed terms deposits, which generates greater investment interest.

Should the leisure centre project be approved then the funding requirements of this and the LATC can be met from cash balances during FY 2016/17 and with external borrowings being required in FY 2017/18.

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise in quarter 1 of 2017. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next eight years are as follows:

2016/17	0.60%
2017/18	1.25%
2018/19	1.75%
2019/20	2.00%
2020/21	2.25%
2021/22	2.50%
2022/23	2.75%
2023/24	2.75%
Later years	3.00%

The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£m	2016/17	2017/18	2018/19
Principal sums invested > 364 days	£3m	£3m	£3m

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

4.6 Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month LIBID compounded

4.7 End of year investment report

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

5 APPENDIX

1. Treasury management practice 1 – credit and counterparty risk management
 2. Approved countries for investments
 3. Treasury management scheme of delegation
 4. The treasury management role of the Section 151 officer
-

APPENDIX 1

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 75% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	6 months
Money market funds	AAA	100%	Liquid
Local authorities	N/A	100%	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use

SPECIFIED INVESTMENTS:

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	Green	In-house

Term deposits with nationalised banks and banks and building societies

	* Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
UK part nationalised banks	Blue	In-house	100%	1 year
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating or Short-term F1, Long-term A-, Sovereign rating AA	In-house	3m	1 year

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
Money Market Funds	MMF rating	In-house and Fund Managers

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

NON-SPECIFIED INVESTMENTS: A maximum £3 million will be held in aggregate in non-specified investment

1. Maturities of ANY period

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: - Structured deposits	See note 1	In-house	3m	2 Years

2. Maturities in excess of 1 year

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	3m	Unlimited
Term deposits – banks and building societies	Purple	In-house	3m	2 Years

APPENDIX 2 : Approved countries for investments

AAA

- Australia
- Canada
- Denmark
- Germany
- Singapore
- Sweden
- Switzerland
- Netherlands

AA+

- Finland
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium

APPENDIX 3

Treasury management scheme of delegation

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Corporate Governance & Finance Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Chief Finance Officer

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

APPENDIX 4

The treasury management role of the Section 151 officer

The Chief Finance 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;
- recommending the appointment of external service providers.