

**SCHEDULE OF ITEMS RECOMMENDED FROM COMMITTEES AND OTHER MEMBER BODIES**

Committee: Council

Date: 26 February 2015

Author: Tracy Couper, Principal Democratic Services Officer

[P193]

<b>Member Body</b>	<b>Report No.</b>
<p><b>1. CORPORATE GOVERNANCE AND FINANCE COMMITTEE – 29 JANUARY 2015</b></p> <p><u>2015/16 Annual Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy Statement and Annual Investment Strategy (AIS)</u></p> <p>The Committee considered a report (reference P185, previously circulated) containing the 2015/16 Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy Statement and Annual Investment Strategy (AIS). The interim Deputy Section 151 Officer explained the background and rationale to the strategies and the changes from the preceding year.</p> <p>Councillor Dupré raised questions regarding the Minimum Revenue Provision referred to in page 5 of the Strategy, which Mr Radford agreed to provide a written answer to.</p> <p>Councillor Dupré referred to the inclusion of Saudi Arabia as a potential country for investments, albeit at the lowest level, in Appendix 5.3 of the Strategy and proposed that this Country should be removed from the list due to its repressive regime and poor record on women’s rights. This was seconded and upon being put to the vote declared to be carried.</p> <p><b>It was resolved to RECOMMEND TO COUNCIL:</b></p> <p><b>That Council approve:</b></p> <ul style="list-style-type: none"> <li>• <b>The 2015/16 Treasury Management Strategy;</b></li> <li>• <b>The Annual Investment Strategy;</b></li> </ul>	<p align="center"><b>P185 (attached at Appendix A)</b></p>

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| <ul style="list-style-type: none"><li>• <b>The Minimum Revenue Provision Policy Statement;</b></li><li>• <b>The Prudential and Treasury Indicators;</b></li></ul> |  |
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**as set out in Appendix 1 to the submitted report, subject to the removal of Saudi Arabia from the list of approved countries for investments in Appendix 5.3 of the report.**

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

Committee: Corporate Governance and Finance Committee

Date: 29 January 2015

Author: Accountant (Treasury Management)

[P185]

1.0 ISSUE

1.1 To consider the 2015/16 Treasury Management Strategy, the Annual Investment Strategy and the Minimum Revenue Provision Policy Statement.

1.2 These strategies and statements will be presented to Full Council for approval on 26 February 2015.

2.0 RECOMMENDATIONS

2.1 That the Corporate Governance and Finance Committee recommends to Full Council to approve:

- The 2015/16 Treasury Management Strategy
- The Annual Investment Strategy
- The Minimum Revenue Provision Policy Statement
- The Prudential and Treasury Indicators.

3.0 BACKGROUND/ OPTIONS

3.1 CIPFA Requirements

The Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management and any subsequent revisions.

3.2 The Treasury Management Policy Statement

As per CIPFA's definition, the Council defines its treasury management activities as:

- The management of the Council'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.

- The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.
- The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

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

- a treasury management policy 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 Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities

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 Council. Such amendments will not result in the Council materially deviating from the Code's key principles.

- Full 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, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
- The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Corporate Governance and Finance Committee, and for the execution and administration of treasury management decisions to the Financial Services Manager, who will act in accordance with the Council's policy statement and TMPs and, if a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- The Council nominates Corporate Governance and Finance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

#### 4.0 APPENDICES

##### 4.1 Appendix 1 - Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy

<b><u>Background Documents</u></b>	<b><u>Location</u></b>	<b><u>Contact Officer</u></b>
The Prudential Code published by CIPFA Treasury Management Practice Schedules  Capital Programme  Finance and Governance Committee 30 January 2014  Budget book and Financial Management System	Room 204 The Grange Ely	Emmanuel Orekogbe Accountant (01353) 616270 E-mail: <a href="mailto:emmanuel.orekogbe@eastcambs.gov.uk">emmanuel.orekogbe@eastcambs.gov.uk</a>

# Treasury Management Strategy Statement Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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EAST CAMBRIDGESHIRE DISTRICT COUNCIL

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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.

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## **Scrutiny**

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

### **1.3 Treasury Management Strategy for 2015/16**

The strategy for 2015/16 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;
- ✓ debt rescheduling;
- ✓ 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. Treasury training has been undertaken by members and further training will be arranged as required.

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.

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## 2 THE CAPITAL PRUDENTIAL INDICATORS 2015/16 – 2017/18

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:

Capital expenditure £m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
<b>Total</b>	<b>4,273</b>	<b>1,084</b>	<b>1,310</b>	<b>490</b>	<b>490</b>

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 £m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	4,273	1,084	1,310	490	490
<b>Financed by:</b>					
Capital grants	3,850	490	200	200	200
Capital reserves / receipts	363	441	1,081	261	261
Revenue	60	124	29	29	29
<b>Net financing need for the year</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

The council is currently considering a scheme to develop a new district wide leisure facility, should this scheme be approved the capital programme will be adjusted to reflect the agreed spend and funding profile

### 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 each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). 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 asked to approve the CFR projections below:

£m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
<b>Capital Financing Requirement</b>					
<b>Total CFR</b>	<b>59</b>	<b>(25)</b>	<b>(47)</b>	<b>(47)</b>	<b>(47)</b>
<b>Movement in CFR</b>	<b>(86)</b>	<b>(84)</b>	<b>(22)</b>	<b>(0)</b>	<b>(0)</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	0	0	0	0	0
Less MRP/VRP and other financing movements	(86)	(84)	(22)	(0)	(0)
<b>Movement in CFR</b>	<b>(86)</b>	<b>(84)</b>	<b>(22)</b>	<b>(0)</b>	<b>(0)</b>

Should the leisure facility be approved during FY 2015/16 there will not be a need to fund any significant capital expenditure until FY 2016/17, so the Treasury management strategy will reflect any changes to the CFR

### 2.3 Minimum revenue provision (MRP) policy statement

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).

CLG regulations have been issued which require the full Council to approve 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.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Repayments included in annual PFI or finance leases are applied as MRP.

## 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.).

The projected level of cash balances are set out below

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Revenue Reserves	5,600	5,246	4,961	4,257	4,880
S106	2,441	2,417	2,417	2,417	2,417
Capital receipts. reserves	1,956	1,439	617	386	145
Cash ( Debtor / Creditors)	2,720	2,500	2,500	2,500	2,500
<b>Total Investments</b>	<b>12,717</b>	<b>9,185</b>	<b>10,495</b>	<b>9,560</b>	<b>9,942</b>

This table shows the council having core funds to invest of around £10 million. However this reduces over the next 3 years, as reserves and receipts are utilised.

There are plans to dispose of some assets, with these proceeds are assumed to fund the new leisure facility.

## 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.

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
%	(2.1)	(1.77)	(1.23)	(1.03)	(1.03)

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

## 2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year 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, which are not published over a three year period.

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

£	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
<b>Council tax band D</b>	5.96	4.08	1.84 **	1.07	1.07

\*\* Decrease in MRP as existing refuse vehicles nears end of asset life.

## 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 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 2014, 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.

£m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
<b>External Debt</b>					
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
<b>Actual gross debt at 31 March</b>	<b>106</b>	<b>22</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>The Capital Financing Requirement</b>	<b>59</b>	<b>(25)</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Under / (over) borrowing</b>	<b>(47)</b>	<b>(47)</b>	<b>0</b>	<b>0</b>	<b>0</b>

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 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.

The Financial Services Manager 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 £m	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	0	0	0	0
Other long term liabilities	106	22	0	0
Total	106	22	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.

- ✓ 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.
- ✓ The Council is asked to approve the following authorised limit:

Authorised limit £m	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	4,894	4,978	5,000	5,000
Other long term liabilities	106	22	0	0
Total	5,000	5,000	5,000	5,000

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### 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. The following table gives a central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2014	0.50	2.50	3.90	3.90
Mar 2015	0.50	2.70	4.00	4.00
Jun 2015	0.75	2.70	4.10	4.10
Sep 2015	0.75	2.80	4.30	4.30
Dec 2015	1.00	2.90	4.40	4.40
Mar 2016	1.00	3.00	4.50	4.50
Jun 2016	1.25	3.10	4.60	4.60
Sep 2016	1.25	3.20	4.70	4.70
Dec 2016	1.50	3.30	4.70	4.70
Mar 2017	1.50	3.40	4.80	4.80
Jun 2017	1.75	3.50	4.80	4.80
Sep 2017	2.00	3.50	4.90	4.90
Dec 2017	2.25	3.50	4.90	4.90
Mar 2018	2.50	3.50	5.00	5.00

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 and especially during 2014, to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 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. There does need to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this initial stage in the recovery to become more firmly established. One drag on the economy is that wage inflation has been lower than CPI inflation so eroding disposable income and living standards, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by warranting increases in pay rates. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen in the near future. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

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

- ✓ As for the Eurozone, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and a triple dip recession since 2008. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- ✓ Investment returns are likely to remain relatively low during 2015/16 and beyond;
- ✓ Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. During July to October 2014, a building accumulation of negative news has led to an overall trend of falling rates. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- ✓ There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

### **3.4 Borrowing strategy**

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 relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Financial Services Manager 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.*
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- ✓ *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 the anticipated rate to US tapering of asset purchases, or 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.*
- ✓ The Financial services manager does not foresee a need to borrow over the next 3 years. However should the council approve the new leisure facility, financing would be required, a combination of long term and short term borrowing.
- At the point when the council makes its decision there will essentially be two funding options:
  - ✓ Raise external borrowing , interest rates are low at present, although they are predicted to increase in the coming years. Any borrowing cost will exceed the interest earned on cash investment
  - ✓ Alternatively, the council could internally borrow, use the core funds to finance the facility, with the leisure centre paying back the borrowing and interest to an agreed time fram. This would be a more cost effective solution and provide greater control for the council. The core funds projected – paragraph 2.4, would be sufficient to fund either the long term funding requirement or a bridging loan, but not both. Therefore, the most likely funding approach is to fund one element from external borrowing. The precise funding solution will depend on interest rates at the time . Should the council approve the new leisure facility, the funding strategy will be a key part of the consideration and the treasury management strategy will reflect this. As described in paragraph 2.4, the council has core funds of around £10 million, which are projected to reduce in the coming years. Should the leisure be approved and any internal takes place, cash balances will reduce further. It is therefore recommended that the current policy of investing for short term period remains the council investment strategy.

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;
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- ✓ 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:

£m	2015/16	2016/17	2017/18
<b>Interest rate exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	25	25	25
<b>Limits on variable interest rates based on net debt</b>	25	25	25
<b>Maturity structure of fixed interest rate borrowing 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 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%	

### 3.5 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. The council could choose to incorporate the funding of the leisure facility into the capital programme, borrow in advance of need and secure very low interest rates. However, there are significant risks around this, the principle one being that the project has not been approved, so borrowing at this time cannot be supported

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. 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.

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.

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.

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.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS prices as an overlay to ratings in our new methodology.

### 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.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This

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change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As with previous practice, ratings will 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.

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 5.2 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices.

## **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

Our creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, 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

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

### 4.3 Counterparty Limits

The 2015-16 Annual Treasury Management Strategy will continue with the limit of £4M as set by management.

### 4.4 Country 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 5.3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### 4.5 Investment strategy

**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 from quarter 2 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015/16 0.75%
- 2016/17 1.25%
- 2017/18 2.00%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

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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:

2015/16 0.90%  
2016/17 1.50%  
2017/18 2.00%  
2018/19 2.50%  
2019/20 3.00%  
2020/21 3.00%  
2021/22 3.25%  
2022/23 3.25%  
Later years 3.50%

**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: -

<b>Maximum principal sums invested &gt; 364 days</b>			
<b>£m</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Principal sums invested > 364 days	£2m	£2m	£2m

Members are advised that should the leisure facility be funded by same internal borrowing that in future years any investment beyond 364 days may cease.

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.

#### **4.7 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.

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## 5 APPENDICES

1. Interest rate forecasts
  2. Economic background
  3. Treasury management practice 1 – credit and counterparty risk management
  4. Approved countries for investments
  5. Treasury management scheme of delegation
  6. The treasury management role of the section 151 officer
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## 5.1 APPENDIX: Interest Rate Forecasts 2014 – 2018

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
<b>Bank Rate View</b>	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yrPW IB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yrPW IB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yrPW IB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yrPW IB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
<b>Bank Rate</b>													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
<b>5yrPW IB Rate</b>													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
<b>10yrPW IB Rate</b>													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
<b>25yrPW IB Rate</b>													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
<b>50yrPW IB Rate</b>													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

## 5.1 APPENDIX: Economic Background

**UK.** Strong UK GDP quarterly **growth** of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), means that the UK will have the strongest rate of growth of any G7 country in 2014. It also appears very likely that strong growth will continue through the second half of 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though recent figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

This overall strong growth has resulted in **unemployment** falling much faster through the initial threshold of 7%, set by the **Monetary Policy Committee (MPC)** last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in **inflation** (CPI) during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. Inflation fell to 1.2% in September, a five year low. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1% and then to remain near to, or under, the 2% target level over the MPC's two year ahead time horizon. Overall, markets are expecting that the MPC will be cautious in raising **Bank Rate** as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q3 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.



The return to strong growth has also helped lower forecasts for the increase in **Government debt** by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

**The Eurozone (EZ).** The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable but has made good progress in reducing its annual budget deficit and in returning, at last, to marginal economic growth. Whilst a Greek exit from the Euro is now improbable in the short term, some commentators still view the inevitable end game as either being another major right off of debt or an eventual exit.

There are also particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 24% and unemployment among younger people of over 50 – 60%. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. Any loss of market confidence in the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

**USA.** The Federal Reserve started to reduce its monthly asset purchases of \$85bn in December 2013 by \$10bn per month; these are expected to stop completely in October 2014. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% (annualised). Annual growth during 2014 is likely to be just over 2%.

The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions. It is currently expected that the Fed. will start increasing rates in mid 2015.

**China.** Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has been mixed. There are also concerns that the Chinese leadership have only started to address an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehman's crisis.

**Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth. In Q2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip.

## **CAPITA ASSET SERVICES FORWARD VIEW**

Economic forecasting remains difficult with so many external influences weighing on the UK. 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, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Over time, an increase in investor confidence in world economic recovery is also likely to compound this effect as recovery will further encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly weighted. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or

when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks currently include:

- ✓ The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.
- ✓ Fears generated by the potential impact of Ebola around the world
- ✓ UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.
- ✓ A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.
- ✓ Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.
- ✓ A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- ✓ A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.
- ✓ Recapitalisation of European banks requiring considerable government financial support.
- ✓ Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- ✓ Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- ✓ France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competitiveness are also urgently required to lift the economy out of stagnation.
- ✓ Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- ✓ Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.
- ✓ There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

The potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- ✓ A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds into 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.

## 5.2 APPENDIX: 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
Enhanced money market funds with a credit score of 1.25	AAA	100%	Liquid
Enhanced money market funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	N/A	100% / 4m per LA	Unlimited
Term deposits with banks and building societies	Yellow Purple Blue Orange Red Green No Colour		Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 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	75	2 Years

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

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

**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 of 75% 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	UK Sovereign rating or Short-term F1, Long-term A-, Sovereign rating AA	In-house	75	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	75	Unlimited
Term deposits – banks and building societies	Purple	In-house	75	2 Years

**The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Financial Services manager, and if required new counterparties which meet the criteria will be added to the list.

### 5.3 APPENDIX: Approved countries for investments

Based on lowest available rating

#### AAA

- ✓ Australia
- ✓ Canada
- ✓ Denmark
- ✓ Germany
- ✓ Luxembourg
- ✓ Norway
- ✓ Singapore
- ✓ Sweden
- ✓ Switzerland

#### AA+

- ✓ Finland
- ✓ Hong Kong
- ✓ Netherlands
- ✓ U.K.
- ✓ U.S.A.

#### AA

- ✓ Abu Dhabi (UAE)
- ✓ France
- ✓ Qatar

#### AA-

- ✓ Belgium
- ✓ Saudi Arabia



## **5.4 APPENDIX: Treasury management scheme of delegation**

### **(i) Full council**

- ✓ approval of annual strategy.
- ✓ approval of/amendments to the organisation's adopted clauses and treasury management policy statement
- ✓ budget approval
- ✓ approval of the division of responsibilities

### **(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;
- ✓ receiving and reviewing reports on treasury management policies, practices and activities;

### **(iii) Financial Services Manager**

- ✓ reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- ✓ approving the selection of external service providers and agreeing terms of appointment.

## **5.5 APPENDIX: The treasury management role of the section 151 officer**

### **The S151 (responsible) 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.