AGENDA ITEM 9

Policy Committee – 11th February 2014

Treasury Management – Treasury Management Strategy Statement 2014/15, Minimum Revenue Policy Statement 2014/15, Annual Investment Strategy 2014/15, and Prudential Indicators 2014/15

Report of the Corporate Head of Financial Management

Ward(s) affected: All

1. Purpose of Report

1.1 This report presents for approval the proposed Treasury Management Strategy together with the Minimum Revenue Provision Policy Statement, Prudential Indicators 2014/15 and Annual Investment Strategy for 2014/15 as required by the Department of Communities and Local Government and CIPFA.

2. Recommendations

It is recommended to Council that:

2.1 The Operational Borrowing Limit for 2014/15 is set at £6.0m

2.2 The Authorised Borrowing Limit for 2014/15 is set at £8.250m

2.3 Councillors delegate authority to the Corporate Head of Financial Management to effect movement within the agreed authorised boundary limits for long-term borrowing for 2014/15 onwards.

2.4 Councillors delegate authority to the Corporate Head of Financial Management to effect movement within the agreed operational boundary limits for long-term borrowing for 2014/15 onwards.

2.5 The treasury management strategy statement 2014/15 is approved.

2.6 The minimum revenue provision policy statement for 2014/15 is approved.

2.7 The treasury management investment strategy for 2014/15 is approved.

2.8 The prudential indicators for 2014/15 which reflect the capital expenditure plans which are affordable, prudent and sustainable be approved.

3. Background Information

3.1 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.

3.2 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.

3.3 The Council's Treasury Management Strategy including prudential indicators and the MRP policy statement is attached at Appendix A. The strategy sets out the limits to borrowing and investments that officers will apply over the coming year in order to ensure the Council's capital investment plans are affordable, prudent and sustainable.

4. The Report

4.1 Treasury Management Strategy

4.1.1 The Council's Treasury Management Strategy including prudential indicators and the MRP policy statement is attached at Appendix A. The strategy sets out the limits to borrowing and investments that officers will apply over the coming year in order to ensure the Council's capital investment plans are affordable, prudent and sustainable.

4.1.2 The Council's 'Authorised Limit for External Debt' is £8.250m for 2014/15, which is the maximum that can be borrowed in the year;

The 'Operational Boundary' (the maximum amount that is expected to be borrowed) is £6.0m in 2014/15, providing £2.25m headroom for any unusual cashflow purposes, should this be required;

4.1.3 Officers will manage the Council's exposure to interest rate variations during the year by working within agreed upper limits for fixed and variable interest rates (variable rate borrowing will be limited to 30%);

4.1.4 Within its Treasury Management Strategy, the Council will contain its exposure to the possibility of loss that might arise as a result of having to seek early repayment or redemption of principal sums, by setting limits for the amounts that can be invested from 7 days to 364 days (ranging from £2.0m down to £0.5m.);

4.1.5 The Council has a range of loans with differing maturity limits in order to smooth out the repayment profile – the value of loans at 01/02/2014 is £5.988m at an average rate of 4.27%;

4.1.6 Total investments are around £8.750m at an average rate of 0.544%.

4.1.7 Minimum Revenue Provision (MRP) Policy for new borrowing will be based on the asset life. Total MRP for 2014/15 is £318k.

4.1.8 Prudential Indicators are calculated based on the Council plans to spend £1.608m on capital projects in 2014/15. This expenditure will be funded from capital receipts, grants or revenue resources.

4.1.9 Principle (Minimum Revenue Provision or MRP) and interest repayments on current and proposed borrowing, less interest on investments, equate to 8.47% of the Net General Fund Budget– even though the Council's external borrowing and investments are almost equal, the cost of borrowing outweighs interest earned.

4.1.10 Taking into account all capital spending plans during 2014/15 it is likely that there will be a need to borrow through utilisation of MRP set-aside.

4.2 Annual Investment Strategy

4.2.1 The priorities for investing the Council's cash reserves are security of capital and liquidity of funds.

4.2.2 Credit ratings and other credit intelligence are used to inform decisions on investments.

4.2.3 Cash balances for investment are expected to range between £6.750m and £8.750m over the coming year dependent upon cashflows.

4.2.4 Interest rates are not forecast to increase over the coming months and therefore sums are being invested over a range of periods of time, to try and achieve the budgeted return and to allow us to take advantage of rising rates as soon as possible.

4.2.5 An average rate of return of 0.544% has been estimated for 2014/15.

5. Implications

5.1 Financial and Value for Money Implications

There are no financial implications as a result of this report. However, the Corporate Head of Financial Management, Finance Manager and Finance Officer will, with advice from the Council's advisor (Capita Asset Services), look to maximise opportunities with the Council's investment and borrowing position.

5.2 **Legal implications**

There are no legal implications as a consequence of this report.

5.3 **Contribution to Council Priorities**

An effective treasury strategy supports a cost effective Council.

5.4 **Risk Management**

Approval of the Treasury Management Strategy enables the Council to comply with Government guidelines. It also contributes to its business and service objectives, and to the effective management of the risks associated with Treasury Management activities.

5.5 **Equality Impact Assessment**

The Council's Equality Impact Assessment Procedure **has been** followed. An Equality Impact Assessment **has not** been completed on the proposals as completion of **Stage 1- Initial Screening** of the Procedure identified that the proposed policy, strategy, procedure or function **does not have** the potential to cause negative impact or discriminate against different groups in the community based on •age • disability •gender • race/ethnicity • religion or religious belief (faith) •sexual orientation, or • rural isolation.

6. Consultations with Others

Treasury strategy is reviewed by the Corporate Leadership Team.

7. Access to Information : Background Documents

Working papers held in Financial Services**.**

8. Author of the Report

Nicola Chick – Interim Finance Manager & Deputy s151
Telephone: 01756 706418
E-mail: nchick@cravendc.gov.uk

9. Appendices

Appendix A – Annual Treasury Management Strategy including MRP Policy Statement and Prudential Indicators 2014/15
Appendix B – Annual Investment Strategy 2014/15

APPENDIX A

TREASURY MANAGEMENT STRATEGY STATEMENT 2014/15

1. Introduction

1.1 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 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:

1.2.1 Treasury Strategy, Prudential and treasury indicators – the report covers:

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

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

1.2.3 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.

1.2.4 Scrutiny – The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Policy Committee.

1.3 The treasury management strategy for 2014/15 covers two main areas:

1.3.1 Capital issues

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

1.3.2 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.

1.4 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.

1.5 Training - the needs of the Council's staff for training in treasury management are assessed regularly.

1.6 The Council uses Capita Asset Services as its external treasury management advisors.

1.6.1 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.

1.6.2 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 2014/15 – 2016/17

2.1 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.

Capital Expenditure

2.2 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 as shown in Table 1.

Table 1: Capital Expenditure Forecasts

Capital Expenditure	2012/13 Actual £'000	2013/14 Forecast £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Grants	172	389	312	312	312
Property	0	333	678	1,325	300
Leisure	0	40	23	0	0
IT	68	133	156	180	110
Vehicles & Equipment	82	591	439	405	245
Other	0	0	0	30	30
Total	**322**	**1,486**	**1,608**	**2,252**	**997**

2.3 Table 2 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.

<u>Table 2: Summary of Financing of Capital Expenditure</u>

Capital Expenditure	**2012/13 Actual £'000**	**2013/14 Estimate £'000**	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Total	**322**	**1,486**	**1,608**	**2,252**	**997**
Financed By					
Capital Receipts	171	816	971	1,431	0
Grants	151	275	187	187	187
Revenue	0	245	0	0	0
Borrowing	0	150	450	634	811

The Councils borrowing need (the capital financing requirement)

2.4 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 as shown in Table 2.

2.5 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 asset's life.

2.6 The CFR includes any other long term liabilities (e.g. 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 does not currently have any such schemes within the CFR.

2.7 The Council is asked to approve the CFR projections in the table 3 below:

Table 3: Capital Financing Requirement Projections

	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000
Capital Financing Requirement					
Total CFR	**5,910**	**5,744**	**5,883**	**6,188**	**6,645**
Movement in CFR	**(322)**	**(166)**	**139**	**305**	**457**
Movement in CFR represented by					
Net financing need for the year (above)	**0**	**150**	**450**	**634**	**811**
Less MRP and other financing movements	**(322)**	**(316)**	**(311)**	**(329)**	**(354)**
Movement in CFR	**(322)**	**(166)**	**139**	**305**	**457**

Core funds and expected investment balances

2.8 The application of resources (capital receipts, reserves or grants) 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 such as asset sales or planned contributions to reserves. Table 4 below shows estimates of the year end balances for each resource.

Table 4: Estimated Core Funds and Investment Balances (Year End)

	2012/13 Actual £'000	2013/14 Estimated £'000	2014/15 Estimated £'000	2015/16 Estimated £'000	2016/17 Estimated £'000
Reserves	2,722	2,415	3,042	3,820	4,837
Capital Receipts	1,294	1,716	976	0	0
Grants	121	38	38	38	38
Total Core Funds	4,137	4,169	4,056	3,858	4,875
Working Capital	6,500	6,500	6,500	6,500	6,500
Expected Investments	4,570	5,000	5,000	5,000	5,000

Affordability prudential indicators

2.9 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:

Ratio of financing costs to net revenue stream

2.10 This indicator shown in table 5 identifies the trend in the cost of capital borrowing (interest and mrp) net of investment income against the net revenue stream.

Table 5: Ratio of Financing Costs

	2012/13 %	2013/14 %	2014/15 %	2015/16 %	2016/17 %
General Fund	17.69	17.29	16.99	17.24	17.21

3. Minimum Revenue Provision Policy Statement

3.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).

3.2 Since 2008 the Council's Minimum Revenue Provision (MRP) liability has been governed by statutory guidance. A general duty has been placed upon local authorities to make an amount of MRP which it considers to be prudent, with responsibility being placed upon the Council to approve an annual MRP policy statement each year.

3.3 The currently agreed policy is that for all expenditure prior to 1 April 2008 funded through borrowing is charged at 4% of the outstanding balance each year. The policy also agreed that all expenditure giving rise to MRP going forward would be charged over a period reasonably commensurate with the asset life.

3.4 As in previous years the Council is recommended to approve the following MRP Statement:

3.5 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
Existing practice - MRP will follow the existing practice outlined in former CLG regulations (known as option 1) this option provided for an approximate 4% reduction in the borrowing need (CFR) each year

3.6 For capital expenditure incurred since 1 April 2008 the MRP policy will be:
Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations known as option 3;

3.7 The Council does not charge MRP on its non-operational assets i.e. those currently under construction. This option is in line with the principle that MRP should only be charged when assets are completed / become operational

4. Borrowing

4.1 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy

Current portfolio position

4.2 The Council's treasury portfolio position at 31 March 2013, with forward projections are summarised in the table below. Table 6 shows the external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 6: Forecasted Portfolio Position

	2012/13 Actual £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
External Borrowing at 1 April	6,238	6,238	5,988	5,988	5,988
Expected change in borrowing	0	(250)	0	0	0
Actual Debt 31 March	**6,238**	**5,988**	**5,988**	**5,988**	**5,988**
CFR – The borrowing need	5,910	5,744	5,883	6,188	6,645
Under (over) / borrowing	**(328)**	**(244)**	**(105)**	**200**	**657**

4.3 The table shows that the Council currently has a small over borrowing position. External debt of £250k was repaid in October 2013 as part of the refinancing of a maturing loan. However from 2015/16 the capital programme indicates that borrowing funds will be required to support its financing. If this turns out not to be the case £500k of exteral loan is due to be repaid in early 2021 and the MRP charge set aside can be used for that .

4.4 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 2014/15 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

4.5 The Corporate Head of Finance 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

Treasury indicators – limits to borrowing activity

4.6 **The operational boundary** – 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. This is shown in table 7.

Table 7: Operational Boundary for Borrowing

	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
	6,238	**6,000**	**6,000**	**6,000**

4.7 **The authorised limit for external debt** – is a further key prudential indicator and represents a control on the maximum level of borrowing. It is the statutory limit determined under section 3 (1) of the Local Government Act 2003, and 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. The Council is asked to approve the authorised limit as set out in table 8

Table 8: Authorised Limit for Borrowing

	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
	8,238	**8,250**	**8,250**	**8,250**

Prospects for interest rates

4.8 The Council's treasury management adviser Capita Asset Services assists the Council to formulate a view on interest rates. The Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Although latest data is showing that economic growth is stronger than forecast and unemployment appears to be falling faster than expected and therefore rates may start to rise sooner than the forecast although this is still felt to be some way off. A forecast for interest rates is shown in table 9.

4.9 Economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 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 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. 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.

4.10 Concerns for the Eurozone have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns 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. Counterparty risks therefore remain elevated and it continues to suggest the use of higher quality counterparties for shorter time period.

Table 9: Forecast for Interest Rates

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

4.11 Investment returns are likely to remain relatively low during 2014/15 and beyond. Borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future.

Borrowing Strategy

4.12 The Council currently has a marginal over-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt rather than cash supporting the Council's reserves, balances and cash flow being used as a temporary measure. This strategy is prudent as interest rates are low. Th eforecast in Table 6 shows that this position will reverse in the next couple of years.

4.13 This strategy will continue, with mrp set aside from revenue being used to fund expenditure within the capital programme identified as suitable for funding from borrowing. The Council's external borrowing is structured to enable choices to be made at the appropriate time to either repay debt or refinance.

4.14 Against his background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Corporate Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

Treasury Limits on Activity

4.15 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. The advice is that they should not be set to be too restrictive otherwise they will impair the opportunities to reduce costs / improve performance.

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments shown in table10.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates shown in table 10.
- 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 shown in table 11.

Table 10: Limit on interest rate exposure

	2014/15	2015/16	2016/17
Upper limit on fixed* interest rate exposures	£6.000m	£6.000m	£6.000m
Upper limit on variable interest rate exposures	£0	£0	£0

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

4.16 All of the Council's investments are deemed to be variable rate as they mature within the next financial year (to be reinvested at, probably, different rates). The upper limits on fixed rate exposures therefore match the Council's operational limit for borrowings, and the value for variable rate exposures enables variable rate borrowing only up to the value of variable rate loans maturing.

Table 11: Maturity Structure of Borrowing

	Upper	Lower
Under 12 months	10%	100%
12 months and within 24 months	15%	0%
24 months and within five years	15%	0%
Five years and within 10 years	20%	0%
10 years and within 25 years	25%	0%
Over 25 years	80%	0%

Policy on Borrowing in advance of need

4.17 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.

4.18 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.

Debt rescheduling

4.19 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

4.20 All rescheduling will be reported to Policy Committee at the earliest meeting following its action.

ANNUAL INVESTMENT STRATEGY 2014/15

1. Investment Policy

1.1 The Council delivers its treasury management in accordance with both the CIPFA Code and the CLG guidance which require it to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**.

1.2 The effect of the Eurozone debt crisis on UK banks and building societies prompted a revision of the Council's definition of "high credit quality" and the monetary and time limits which should be applied when considering an investment vehicle. The limits are summarised in table 12 below.

Table 12: Investment Limits

<table>
<tr><th></th><th>Rating</th><th>Cash limit</th><th>Time limit</th></tr>
<tr><td rowspan="3">Banks and other organisations (excluding those listed below) whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:-</td><td>A+ up to AAA</td><td>£1,000,000</td><td>364 days</td></tr>
<tr><td>A</td><td>£500,000
or
£1,000,000</td><td>6 months

3 months</td></tr>
<tr><td>A-</td><td>£500,000
or
£1,000,000</td><td>3 months

1 month</td></tr>
<tr><td colspan="2">Council's current bankers</td><td>£2,000,000</td><td>7 days</td></tr>
<tr><td colspan="2">UK building societies whose lowest published long-term credit rating is BBB+ <u>and</u> societies without credit ratings with assets greater than £250m</td><td>£1,000,000
each
or
£500,000</td><td>3 months

6 months</td></tr>
<tr><td colspan="2">Money market funds whose lowest published credit rating is AAA</td><td>£1,000,000
each</td><td>n/a</td></tr>
<tr><td colspan="2">UK Central Government (irrespective of credit rating)</td><td>unlimited</td><td>364 days</td></tr>
<tr><td colspan="2">UK Local Authorities without credit ratings (per LA)</td><td>£1,000,000</td><td>364 days</td></tr>
</table>

1.3 All investments will be transacted and held in pounds sterling. No investments will be transacted direct with any foreign bank.

1.4 There is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation providing that it meets the credit rating criteria above. This reflects a lower likelihood that central government will support failing banks following the report of the Independent Commission on Banking.

UK Building Societies

1.5 In line with previous years investment strategies UK building societies without credit ratings will be considered to be of "high credit quality", but will require a minimum asset base.

1.6 The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors.

1.7 However, the Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and therefore investments in lower rated and unrated building societies will be kept under continuous review.

1.8 No investments will be made with building societies that hold a long-term credit rating lower than BBB+ or equivalent, due to the increased likelihood of default implied by this rating.

Money Market Funds

1.9 Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council.

1.10 Only funds that offer same-day liquidity and a constant net asset value will be used as an alternative to instant access call accounts.

Risk Assessment and Credit Ratings

1.11 The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc. and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

1.12 Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is very unlikely the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

1.13 Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the above criteria then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled, and
- full consideration will be given to the recall of any other existing investments.

1.14 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks.

Other information on the security of investments

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

1.16 When deteriorating financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.

1.17 If these restrictions mean that insufficient commercial organisations of "high credit quality" are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Non-specified investments

1.18 The CLG Guidance defines *specified* investments as those:

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

The Council does not intend to make any non-specified investments.

Liquidity management

1.19 The Council uses recommended cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

2. Planned investment strategy for 2014/15

2.1 The cash flow forecast will be used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.

- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

2.2 Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored.
Instant-access AAA-rated money market funds and bank instant-access deposit accounts will be the main methods used to manage short-term cash.

2.3 Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations.

2.4 The Council does not currently place long-term investments. With short and medium-term interest rates currently much lower than long-term rates, due consideration will also be given to using surplus funds to make early repayments of long-term borrowing. In addition to the savings on the interest rate differential, this strategy will also reduce the Council's exposure to credit risk and interest rate risk.

3. <u>Policy on Use of Financial Derivatives</u>

3.1 Local authorities (but not this Council) have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

3.2 The Localism Bill 2011 includes a general power competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

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

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

4. Investment Indicators

4.1 The Council measures and manages its exposures to treasury management risks using a number of indicators which the Council is asked to approve:

- Security: average credit rating – This is a voluntary measure of its exposure to credit risk achieved by monitoring the weighted average credit rating of its investment portfolio shown in table 13.
- Liquidity: cash available within three months – This is a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period shown in table 14.
- Principal sums invested for periods longer than 364 days – The limits on the total principal sum invested to final maturities beyond the period end will be shown in table 15.

Table 13: Average Credit Rating

	Target
Portfolio average credit rating	A-

Table 14: Liquidity of Cash Available

	Target
Total cash available without borrowing	£2m
Total cash available including borrowing	£2m

Table 15: Limit of Principal Sums Greater than 364 Days

	2013/14	2014/15	2015/16
Limit on principal invested beyond 364 days	£0	£0	£0

5. Other Matters

5.1 The CLG Investment Guidance requires the Council to note the following matters each year as part of the investment strategy:

Treasury Management Advisers

5.2 The Council's treasury management adviser – Capita Asset Services was appointed from 1 April 2013 for a three year period.

5.3 Capita provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

5.4 The quality of this service is controlled by periodic review, and the current contract expires on 31st March 2016.

Investment training

5.5 The needs of the Council's staff for training in treasury management are assessed every six months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Treasury Management adviser organisations and CIPFA.

Investment of money borrowed in advance of need

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

5.7 The total amount borrowed will not exceed the authorised borrowing limit. The maximum periods between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

Other Options Considered

5.8 The CLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below in table 16:

Table 16: Alternative Strategies & Risk

Alternative	**Impact on income and expenditure**	**Impact on risk management**
Adopt a narrower definition of "high credit quality" and/or shorter time limits	Interest income will be lower	Reduced risk of losses from credit related defaults
Adopt a wider definition of "high credit quality" and/or longer time limits	Interest income will be higher	Increased risk of losses from credit related defaults
Borrow additional sums at long-term fixed interest rates	Due to lower interest rates currently available, debt interest costs can be contained within budget levels while increasing the maximum borrowing limit	Higher investment balance until expenditure is defrayed leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain