Report of the Strategic Director Corporate Services to the meeting of Governance and Audit Committee to be held on 28 March 2017.

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Subject:

Treasury Management Policy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy 2017/18.

Summary statement:

This report shows the Council's Treasury Strategy for borrowing for the three financial years commencing 2017/18 and the Annual Investment Strategy for 2017/18.

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Portfolio:
Leader

Overview & Scrutiny Area:

Corporate

Treasury Management Strategy Policy Statement
Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2017/2018

Introduction

1.1 Background

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

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

CIPFA defines treasury management as:

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

1.2 Reporting requirements

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

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

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

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

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

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

Treasury Management Strategy for 2017/18

The strategy for 2017/18 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
- Treasury Policy Changes/Issues

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.

1.3 Training

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

1.4 Treasury management consultants

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

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

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

2.0 The Capital Prudential Indicators 2017/18 -2019/20

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.

Capital expenditure	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
	70	80	124	155	44

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. 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.

Financing of capital expenditure	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Capital receipts	5	6	8	10
Capital grants	40	52	54	72
Revenue & Reserves	7	4		
Net financing need for the year	18	19	61	73

As part of the local government settlement the Government announced greater flexibility for councils in how they make use of capital receipts. Councils were previously only allowed to spend such money on further capital projects or repay debt. But now capital receipts can be used to fund the revenue costs of transformation projects which are designed to generate ongoing revenue savings in the delivery of public services and/or to transform service delivery in a way that reduces costs or demand for services in the future.

There are no plans to use this flexibility in the 2017/18 financial year. However, given the size and scale of the transformation programme it is possible that the Council may seek approval from the Secretary of State to use capital receipts in this flexible manner in the future.

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 currently has £199m of such schemes within the CFR.

£m	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Capital Financing Requirement					
Total CFR	666	653	675	707	720
Movement in CFR		-13	+22	+32	+13

2.3 Minimum revenue provision (MRP) policy statement

The Local Government Act 2003 requires the Council to make a provision for the repayment of borrowing used to finance its capital expenditure, known as the Minimum Revenue Provision (MRP).

The MRP is the amount of principal capital repayment that is set aside each year in order to repay the Capital Financing Requirement (CFR) based on the requirement of statutory regulation and the Council's own accounting policies.

The Council is required to state as part of its budget process the policy for determining its MRP. The policy was changed last year generating savings in the current and future years. There are no proposed changes to the policy adopted last year. The method for calculating the MRP on each category of debt is outlined below:

a) The policy for charging MRP on historic supported borrowing is on the asset life method calculated on an equal instalment basis over 50 years.

b) Unsupported or prudential borrowing MRP is based on the Asset Life method – that is, the expenditure financed from borrowing is divided by the expected asset life. For schemes funded before 31st March 2012 the MRP is calculated on the annuity basis and for schemes funded after 1st April 2012 the MRP is calculated on an equal instalment basis. This means no change to existing policy.

c) Since 2009/10 the appropriate financing costs for the Council's Building Schools for the Future (BSF) Private Finance Initiative (PFI) schemes have been included in MRP calculations.

The CFR represents the amount of capital expenditure that has been financed from borrowing, less any amounts that the Council has set aside to repay that debt through the MRP. Borrowing may come from loans taken from the Public Works Loan Board (PWLB) or commercial banks, finance leases (including PFI) or from the use of the Council's own cash balances.

2.4 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.

2.5 Ratio of financing costs to net revenue stream

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

%	2015/16 Actual %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
Ratio	16	15.5	16.2	16.5	16.7

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

2.6 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.

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

£	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council tax - band D	0	0	0	0	0

3.Treasury Management

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2016, 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	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
External Debt					
Debt at 1 April	391	338	341	342	342
Expected change in Debt	-53	+4			
Other long-term liabilities (OLTL)	203	195	191	187	183
Expected change in OLTL	-8	-4	-4	-4	-4
Actual gross debt at 31 March	533	533	528	525	521
The Capital Financing Requirement	666	653	675	666	653
Under / (over) borrowing	133	120	147	141	132

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 2017/18 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 Strategic Director Corporate Services 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	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Debt	380	400	400	400
Other long term liabilities	220	220	220	220
Total	600	620	620	620

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

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

Authorised limit £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Debt	400	440	440	440
Other long term liabilities	240	240	240	240
Total	640	680	680	680

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 our central view.

	NOW	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
BANK RATE	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.75	0.75
3 month LIBID	0.23	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.60	0.70	0.80	0.90
6 month LIBID	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.70	0.80	0.90	1.00
12 month LIBID	0.63	0.70	0.70	0.70	0.70	0.70	0.80	0.80	0.90	1.00	1.10	1.20	1.30	1.40
5 yr PWLB	1.38	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	2.11	2.30	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.70
25 yr PWLB	2.78	2.90	2.90	2.90	3.00	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.30	3.40
50 yr PWLB	2.54	2.70	2.70	2.70	2.80	2.80	2.80	2.90	2.90	3.00	3.00	3.10	3.10	3.20

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, to combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
    - Italian constitutional referendum 4.12.16 resulted in a ‘No’ vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
    - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
    - Dutch general election 15.3.17;

    - French presidential election April/May 2017;
    - French National Assembly election June 2017;
    - German Federal election August – October 2017.

- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. Funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. 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 capital expenditure and/or to

refinance maturing debt; this resulted in borrowing being undertaken in December detailed in the Borrowing Strategy paragraph 3.4.

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference 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 sensible as investment returns are low and counterparty risk is still an issue that needs to be considered.

The level of underborrowing has increased over the last two years and a decision was made in December to take advantage of currently low interest rates to borrow against loans maturing in March 2017.Loans to the value of £25.9m were therefore taken out at an average rate of 2.6187%, and will replace loans of the same amount maturing in March, that have a average interest rate of 8.947%.This will reduce the average interest rate on the overall debt portfolio by 0.5% in March 2017, saving £1.65m per year.

With the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Strategic Director Corporate Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

3.5 Treasury management limits on activity

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

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

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

1	2017/18	2018/19	2019/20
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	+175%	+175%	+175%
Limits on variable interest rates based on net debt	+20%	+20%	+20%
Maturity structure of fixed interest rate borrowing 2017/18			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	20%
2 years to 5 years		0%	50%
5 years to 10 years		0%	50%
10 years to 20 years		0%	50%
20 years to 30 years		0%	90%
30 years to 40 years		0%	90%
40 years to 50 years		0%	90%
Maturity structure of variable interest rate borrowing 2017/18			
		Lower	Upper
Under 12 months		0%	20%
12 months to 2 years		0%	20%
2 years to 5 years		0%	20%
5 years to 10 years		0%	20%
10 years to 20 years		0%	20%
20 years to 30 years		0%	20%
30 years to 40 years		0%	20%

40 years to 50 years	0%	20%

3.6 Policy on borrowing in advance of need

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

3.7 Debt rescheduling

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).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Governance and Audit Committee, at the earliest meeting following its action.

Municipal Bond Agency It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB), but at present this remains uncertain.

3.8. Annual Investment Strategy

3.8.1 Investment policy

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

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

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

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

Investment instruments identified for use in the financial year are listed in appendix 1 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.

3.8.2 Creditworthiness policy

The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

The Strategic Director Corporate Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks/Building Society 1 - good credit quality **–** the Council will only use banks which:
    1. are UK banks/building Society; and/or
    2. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA-

    and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

    Short Term – S&P A-1,Fitch F1 and Moody's P-1

    Long Term – Moody's Aa3
- Banks/Building Society Banks 2 – same as Bank 1 apart from Moodys rating of A1.
- Banks/Building Society 3 – a credit rating of a least one of the following Moody's long term A3, Fitch short term F1 or S & P short term A-1.
- Banks Part nationalised UK bank 4 – Nat West Bank. This bank can be included provided it continues to be part nationalised or it meets the rating in Bank /Building Society 1, 2 or 3 above.
- Bank 5 – The Council's own banker for transactional purposes if the bank falls below the above criteria although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operations-The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Money Market Funds (MMFs) – AAA Moody's Fitch or S&P
- Local authorities, parish councils etc
- UK Government

A limit of 20% will be applied to the use of non-specified investments

Use of additional information other than credit ratings. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Limit	Time Limit
Banks/Building Society 1	**£30m**	**2yrs**
Banks/Building Society 2	**£20m**	**1yr**
Banks/Building Society 3	**£7m**	**100 days**
Bank 4 Nat West Bank	**£20m**	**1yr**
Council's banker if below above criteria		**Day exposure**
Temporary exception from the Treasury policy for schools balances until the main academy conversion process has finished.		**Until academy process completed**
DMADF	**unlimited**	**6 months**
Local authorities	**£20m**	**1yr**
Money market funds	**£20m**	**Liquid**
UK Government	**No limit**	**2yrs**

The proposed criteria for specified and non-specified investments are shown in Appendix 1 for approval.

3.8.3 Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the Council's investments.

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

3.8.4 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 stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%

- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

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

	Now
2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

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

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

Maximum principal sums invested > 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 364 days	£20m	£20m	£20m

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

3.8.5 Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, month LIBID compounded uncompounded

3.8.6 Treasury Policy Changes /Issues.

The cash balances for the Council are invested at present in liquidity funds ,term deposits, certificate of deposits and Treasury bills. The money market has undertaken great change since 2008 with the number of banks available for the council to invest in and their funding requirements reducing.

With this in mind I purpose we increase the products we are able to invest in to include the following
a)bonds issued by the UK Government and banks/ building society including covered bonds (see Appendix 2 for explanation of these products).

b) Floating rate notes again issued by the UK Government and banks/ building society including covered.

The maturity and credit rating would follow the same criteria as our current investments.

These additions would help in the following way without increasing risk.

i) certain banks only issue in the products above .
ii better rates may be available than we are able to gain from the products we use at present.
iii) Covered bonds and covered floating rate notes have better credit ratings and so offer another layer of protection.
iv) Both bonds and floating rate note notes are tradable and so can be sold before they mature which gives us greater flexibility.

3.8.7 The following change to the Treasury Policy is recommended

Bonds and Floating rate notes issued by the UK government, Banks and Building societies (including covered) be added to the Treasury Policy.

3.8.8 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.

4. Options

4.1 None.

5. Financial and Resources Appraisal

5.1 The financial implications are set out in section

6. Risk Management

6.1 The whole set of policies and day to day operations of treasury management are designed to assess and mitigate risk.

7. Legal Implications

7.1 Any relevant implications are set out in report.

8. Other Implications

8.1 Equal Rights implications-
8.2 Sustainability implications – no direct implications
8.3 Greenhouse Gas Emissions Impact – no direct implications
8.4 Community safety implications – no direct implication.
8.5 Human Rights Act – no direct implications
8.6 Trade Unions – no direct implications
8.7 Ward implications – no direct implications

9.Not for publications document

10.Recommendations.

10.1 That the Treasury policy set out in section 3.8.7 be noted by Governance and Audit Committee and passed to full council for adoption.

11. Background Documents

Treasury Management Schedules

Treasury Management Schedules

Treasury Policy

12.Appendices

1.Specified and Unspecified Investments

2.Definition of Bonds ,Covered Bonds and Floating Rate notes.

3.Approved countries for investments

4.Treasury management scheme of delegation

5.The treasury management role of the section 151 officer

Appendix 1 Specified and Unspecified Investments

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.

	Minimum credit criteria	**Use**
Debt Management Agency Deposit Facility	UK sovereign rating	In house
Bonds issued by banks and building societies (including covered)	Moody’s Aa3,Fitch F1 and S & P A-1 or above	In house
Bonds issued by banks and building societies	Moody’s A1, Fitch F1 and S&P A-1 or above	In house
UK Government Treasury bills	UK sovereign rating	In house
Money Market Funds	AAA	In house
Local authorities	N/A	In house
Term deposits with banks and building societies	Moody’s Aa3,Fitch F1 and S & P A-1 or above	In house
Term deposits with banks and building societies	Moody’s A1, Fitch F1 and S&P A-1 or above	In house

	Minimum credit criteria	Use
Term deposits with banks and building societies	At least one of Moody's A3, Fitch F1	In house
Certificates of deposit issued by banks and building societies	Moody's Aa3,Fitch F1 and S & P A-1 or above See note 1	In-house
Certificates of deposit issued by banks and building societies	Moody's A1,Fitch F1 and S & P A-1 or above	In house
Floating rate notes issued by banks and building societies(including covered)	Moody's Aa3,Fitch F1 and S & P A-1 or above	In-house
Floating rate notes issued by banks and building societies	Moody's A1,Fitch F1 and S & P A-1 or above	In house
UK Government Bonds	Sovereign rating	In house

NON-SPECIFIED INVESTMENTS: A maximum of 20% will be held in aggregate in non-specified investment

1. Maturities of ANY period

	Minimum Credit Criteria	Use
Term deposits with unrated counterparties with unconditional guarantee from parent	Moody's A3, Fitch F1 and S&P A-1 or above	In-house

2. Maturities in excess of 1 year

	Minimum Credit Criteria	**Use**	**Max. maturity period**
Term deposits – banks and building societies	Moody's Aa3,Fitch F1 and S & P A-1 or above	In-house	2 years
Certificates of deposit issued by banks and building societies	Moody's Aa3,Fitch F1 and S & P A-1 or above	In-house	2 years
Floating rate notes issued by banks and building societies(including covered)	Moody's Aa3,Fitch F1 and S & P A-1 or above	In house	2 years
Bonds issued by banks and building societies(including covered)	Moody'sAa3 Fitch F1and S&P A-1 or above	In house	2 years
Bonds issued by UK government	Sovereign rating	In house	2 years

Appendix 2 Definition of Bonds,Floating rate notes

3.1 Floating rate notes (FRNs) are bonds that have a variable coupon, equal to a money market reference rate, which is the London Interbank Over Rate (the rates leading banks charge each other for short term loans) plus an additional amount called spread (generally an extra 0.05% to 0.30% depending on the credit and market conditions). Almost all FRNs have quarterly coupons, i.e. they pay out interest every three months. At the beginning of each coupon period, the coupon is calculated by taking the LIBOR 3 month rate and adding on the spread. A typical coupon would look like 3 months LIBOR +0.20%.The note is negotiable, that is, it can be sold at any time in the secondary market.

3.2 A bond is an instrument of indebtedness of the bond issuer to the holders. It is a debt security, under which the issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay them interest (the coupon) and/or to repay the principal at a later date, termed the maturity date. Interest is usually payable at fixed intervals (semiannual, annual). The bond is negotiable, that is, the bond can be sold at any time in the secondary market.

3.3 Covered bonds/Floating rate notes are debt securities issued by a bank/ building societies and collateralised against a pool of assets that, in case of failure of the issuer, can cover claims at any point of time. They are subject to specific legislation to protect bond holders. This means that this bonds have a higher level of protection than a normal bond and so have better credit ratings The down side is that the return on these assets is lower.Again the instrument can be sold at any time.

Appendix 3 Approved countries for Investments

AAA

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

AA+

- Finland
- Hong Kong
- U.S.A.

AA

- France
- U.K.

AA-

- Belgium

Appendix 4 Treasury Management Scheme of Delegation.

(i) Full council

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

(ii) Governance and Audit Commitee Boards

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

(iii) Internal Audit

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

Appendix 5 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;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- approving the appointment of external service providers.