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# Report of the Director of Finance to the meeting of Governance and Audit Committee to be held on 18 March 2016.

**AN**

## Subject:

**Treasury Management Policy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy 2016/17.**

## Summary statement:

**This report shows the Council's Treasury Strategy for borrowing for the three financial years commencing 2015/16 and the Annual Investment Strategy for 2015/16.**

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**Portfolio:**
**Leader**

**Overview & Scrutiny Area:**

**Corporate**

**Treasury Management Policy Statement,**
Minimum Revenue Provision Strategy and Annual Investment Strategy 2016/2017

# 1 Introduction

## 1.1 Background

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

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

CIPFA defines treasury management as:

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

## 1.2 Reporting requirements

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

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

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

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

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

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

## 1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

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

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

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

## 1.4 Training

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

## 1.5 Treasury management consultants

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

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

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

## 2 The Capital Prudential Indicators 2016/17 -2018/19

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

### 2.1Capital 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 | 2014/15 Actual £m | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|---|
| **Capital Expenditure** | **114** | **81** | **133** | **58** | **68** |

### 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. Each year, a minimum revenue provision (MRP) is charged to the Council's revenue budget (see further details below).

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 £193m of such schemes within the CFR.

| | 2014/15 Actual £m | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | **679** | **671** | **719** | **733** | **735** |

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

The Council is required to pay off an element of the accumulated Capital Financing Requirement (CFR) through a revenue charge (the minimum revenue provision - MRP).The MRP a statutory charge which broadly reduces the borrowing need in line with each assets life. In this way capital expenditure (as measured through the CFR)is over time , paid for through the revenue budget.

DCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. Bradford like most other authorities continued to use the regulatory method for calculating MRP on supported borrowing, whilst adopting the Asset Life (Equal instalment) method for un-supporting borrowing. The regulatory method is based on a charge of 4% on the outstanding debt. This has the disadvantage that the actual charge differs each year being higher in earlier years then reducing year after year. Moreover the debt is never actually paid off as the annual charge reduces with the opening debt. For example if the Council continues to use the regulatory method it would still have £43.7m of this debt outstanding after 50 years. A change to the asset life method in equal instalments is considered more financially prudent as the repayments are paid in equal instalments over a fixed period.

The proposed method for calculating the MRP on each category of debt is outlined below:

a) The policy for charging MRP on historic supported borrowing be changed to the asset life method calculated on an equal instalment basis. This brings it into line with the MRP policy for prudential borrowing. The historic supported borrowing cannot be tied to specific assets. Therefore an assumed asset life has to be used. Most of the Council's operational buildings have been given estimated lives of between 40 and 60 years. Therefore it is proposed to use an assumed life of 50 years. This is considered more prudent than the regulatory method as the debt will be paid in a fixed period of 50 years. This means a change to policy used hitherto.

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 adjusted as relevant where the estimated asset life is different to the PFI contract life and financing period. This means no change to existing policy.

d) Core funds and expected investment balances

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

## 2.4 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators. In addition, this framework includes prudential indicators of the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall finances.

## 2.5 Council's 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.

| % | 2014/15 Actual % | 2015/16 Estimate % | 2016/17 Estimate % | 2017/18 Estimate % | 2018/19 Estimate % |
|---|---|---|---|---|---|
| Ratio | 15.6 | 15.8 | 14.8 | 15.4 | 15.0 |

The estimates of financing costs include current commitments and the proposals in this budget report. What this indicator shows is that burden on the annual revenue budget which arises from capital expenditure is being maintained at a constant rate. This is an important element of the capital expenditure strategy at a time when the annual revenue budget continues to shrink in line with austerity.

## 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.

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

| | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **Council tax - band D** | £0.00 | £0.00 | £0.00 | £0.00 | £0.00 |

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

| £m | 2014/15 Actual £m | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 418 | 391 | 338 | 337 | 337 |
| Expected change in Debt | (27) | (53) | (1) | 0 | 0 |
| Other long-term liabilities (OLTL) | 202 | 195 | 191 | 187 | 183 |
| Expected change in OLTL | (7) | (4) | (4) | (4) | (4) |
| Actual gross debt at 31 March | 620 | 586 | 529 | 524 | 520 |
| The Capital Financing Requirement | 679 | 671 | 719 | 733 | 735 |
| Under / (over) borrowing | 59 | 85 | 190 | 209 | 215 |

Based on the current forecast level of capital expenditure the Table above shows that the gap between the CFR and external borrowing is expected to grow over the next few years. The difference is met from the Council's own funds sometimes referred to as internal borrowing. This is sustainable as long as those funds are not required for another purpose – for example, reserves or grants that have not yet been used.

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

The Director 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.

**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 | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|
| Debt | 380 | 380 | 380 |
| Other long term liabilities | 220 | 220 | 220 |
| Total | 600 | 600 | 600 |

**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 | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|
| Debt | 400 | 400 | 400 |
| Other long term liabilities | 240 | 240 | 240 |
| Total | 640 | 640 | 640 |

These limits assume that the Council will be able to sustain a level of internal borrowing based on current forecasts of cash balances. This position will be monitored over the next year to determine whether the limits need to be reviewed in future years.

### 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.

| | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.50% | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% |
| 5yr PWLB rate | 2.00% | 2.10% | 2.20% | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% |
| 10yr PWLB rate | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.60% | 3.70% |
| 25yr PWLB rate | 3.40% | 3.40% | 3.50% | 3.60% | 3.70% | 3.70% | 3.80% | 3.90% | 4.00% | 4.00% | 4.10% | 4.10% | 4.10% |
| 50yr PWLB rate | 3.20% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 3.90% | 4.00% | 4.00% | 4.00% |

**UK.** UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK.

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase.

However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

**USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**Eurozone.** In the Eurozone,in January the European Central Bank unleashing a massive €1.1 trillion programme of quantitative easing (QE) to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.
Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

**Banking Sector** .In January and February equity markets have been hit hard by the continued falling oil prices, issues in China and concerns over the possabilty of recession in the major economics. This has reduced the likelihood of interest rate raises but also raised issues again about the banking sector. With their share prices and debt been hit hard.

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

### 3.4 Borrowing strategy

Over the past year the Council has repaid £53 million of maturing debt bringing its level of external debt down to £338m.This has resulted in a reduction in a reduction in cash balances. Given this reduction combined with the forecast use of reserves and the underborrowed position means that the Council now expects to maintain this level of external borrowing over the next few years. This will be maintained by replacing maturing loans. The under-borrowed position means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations.

The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances: 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 and is still set at +20%.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates which is set at 175%.

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

| £m | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|
| **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 2016/17** | | | |
| | | **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 2016/17** | | | |
| | | 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

## 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 Director of Finance 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/building societies which:

  i. are UK banks/building societies; and/or

  ii. 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 Poor's credit ratings (where rated):

  i. Short Term – S & P A-1 Fitch F1 and Moodys P-1

  Long Term – Moody's Aa3

- Banks/ Building Society 2 same as Bank 1 apart from Moody's rating of A1
- Banks/ Building Society 3 a credit rating of at 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 ratings in Banks/ Building Society 1, 2 or 3 above.
- Banks 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 operation -. 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

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) 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):

| | | Money Limit | Time Limit |
|---|---|---|---|
| Banks/Building Society 1 | | £30m | 2yrs |
| Banks/Building Society 2 | | £20m | 1yr |
| Banks/Building Society 3 | | £7m | 100 day |
| Nat West Bank | | £20m | 1yr |
| Councils bank if below above criteria | | | Day exposure |
| Local authorities | | £20m | 1yr |
| | | | |
| Money market funds | | 20m | Liquid |
| Co-op Bank temporary until alternative banking arrangements can be made | | | Day exposure |

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 2. 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 remain unchanged at 0.5% before starting to rise from quarter 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.60%
- 2017/18 1.25%
- 2018/19 1.75%

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

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

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

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

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

| **Maximum principal sums invested > 364 days** | | | |
|---|---|---|---|
| **£m** | **2016/17** | **2017/18** | **2018/19** |
| Principal sums invested > 364 days | £20m | £20m | £20m |

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to100 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 LIBID compounded .

### 3.8.6 School Bank Balances

In the last Treasury report the investment limits for the four main UK banks were reduced,and changed to using the same credit criteria as the other banks/ building societies . This mean't that Lloyds limit changed to £20m and Barclays to £7m limited to 100 days.

This raised the following/new issues

i)Bradford schools- The schools have their own individual balances with the four main banks.At present their overall balances with Lloyds and Barclays exceed the new Treasury policy limits.

ii)Further more it should be noted that centrally held cash balances have, and are going to continue to,reduce significantly(due to repayment of loans and use of reserves). This will mean that the investment limits for our counterparties will reduce in the near future,most likely in the next report.

iii)It also means that a large percentage of the overall cash held by the council could be in the schools bank accounts, concentrated in a few counterparities.

Proposal

Review undertaken on schools balances and progress reported in the next Treasury report.

**3.8.7 End of year investment report**

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

**4. Options**

4.1 None

**5. Financial and Resources Appraisal**

5.1 The financial implications are set out in section 1,2,3 and 4

**6. Risk Management**

6.1 None

**7. Legal Implications**

7.1 Any relevant implication considerations are set in the report.

**8. Other Implications**

8.1 Equal Rights implications –
8.2 Sustainabilty implications – no direct implications
8.3 Green house Gas Emissions Impact- no direct implications
8.4 Community safety implications- no direct implications
8.5 Human Rights Act – no direct implication
8.6 Trade Unions – no direct implications
8.7 Ward Implications – no direct implications

**9. Not for publications documents**

None

## 10. Recommendations

10.1 That the Treasury policy be noted by Governance and Audit Committee and passed to full council for adoption.

## 11. Appendices

Appendix 1 Specified and Unspecified Investments

Appendix 2 Approved countries for investments

Appendix 3 Treasury management scheme of delegation

Appendix 4 The treasury management role of the section 151 officer

**Appendix 1**
**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 | - | In-house |
| Term deposit –local authority | - | In-house |
| Term deposits – banks and building societies | Moody's Aa3 ,Fitch F1 and S & P A-1 or above | In-house |
| Term deposits – banks and building societies | Moody's A1 ,Fitch F1 and S & P A-1 or above | In-house |
| Term deposits – banks and building societies | At least one of Moody's A3 ,Fitch F1 and S & P A-1 or above | In-house |
| Certificate of deposit issued by banks and building societies | Moody's Aa3 ,Fitch F1 and S & P A-1 or above | In-house |
| Certificate of deposit issued by banks and building societies | Moody's A1 ,Fitch F1 and S & P A-1 or above | In-house |
| Certificate of deposit issued by banks and building societies | At least one of Moody's A3 ,Fitch F1 and S & P A-1 or above | In-house |
| Part Nationalised Bank | Sovereign Rating | In-house |
| Money Market Funds | AAA either Moody's Fitch or S & P | In-house |

| Treasury Bills | UK 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 | - At least one of Moody's A3 ,Fitch F1 and S & P A-1 or above - | In-house |
| Co-op specific Account | Until the Director of Finance can find alternative arrangements- | In-house Accountancy |

**Maturities in excess of 1 year**

| | **Minimum Credit Criteria** | **Use** | **Max. maturity period** |
|---|---|---|---|
| Term deposit –local authority | - | In-house | 2 years |
| 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 S & P A-1 | In-house | 2 years |

## Appendix 2: Approved countries for investments

AAA

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

AA+

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

AA

- 
- France

AA-

- Belgium

## Appendix 3: 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

- 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 4: 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.