Public
Key Decision – No

HUNTINGDONSHIRE DISTRICT COUNCIL

Title:	**2014/15 Treasury Management Strategy**
Meeting/Date:	**Cabinet** 13 February 2014
Executive Portfolio:	**Resources: Councillor J A Gray**
Report by:	**Assistant Director (Finance and Resources)**
Ward(s) affected:	**All Wards**

Executive Summary:
The Council is required by law to approve, on an annual basis a Treasury Management Strategy; this requirement is enshrined within relevant Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy and other guidance issued by central government.

The aim of the Treasury Management Strategy is to manage the Council's investments, cash flows, banking, money market and capital market transactions within the requirements of an effective control environment but coupling this with the pursuit of optimum performance consistent with those risks.

The approval of the Treasury Management Strategy rests with Full Council, with oversight being undertaken by the Cabinet. To support the Cabinet, the Leader, Deputy Leader, Portfolio Holder for Resources and the Chairman of the Overview & Scrutiny Panel (Economic Well-Being), as well as relevant officers, attend the Treasury Management Advisory Group (TMAG). The role of TMAG is to comment on current and future Treasury Management activity.

Highlights of the 2014/15 Treasury Management Strategy include:

- The operation of the strategy within an economic climate that is showing moderate growth but where the likelihood is that interest rates will remain low into the medium term.
- An increase in net borrowing costs due to the Council no longer holding investments at advantageous rates of interests.
- The continuation of the Councils policy to:
  - take advantage of borrowing in advance of need, and
  - the provision of loans to organisations that meet either service objectives or to support local organisations in their development where risk is mitigated by appropriate financial security.
- The addition of Pooled Property Funds for longer term investing purposes.

Recommendation(s):
It is recommended that Overview and Scrutiny notes the report and recommends to Cabinet and then to Council the approval of:

- The Treasury Management Policy, Annex B.
- The Treasury Management Strategy, Annex C.

1. PURPOSE

1.1 The aim of the Treasury Management Strategy is to provide strategic guidance on how the Council shall conduct its Treasury Management activity. The Strategy shall:

- Include relevant policies, objectives and treasury/prudential indicators; as well as illustrating its approach to risk management.
- Comply with the Code or Practice for Treasury Management and the Prudential Code for Capital Finance (as issued by the Chartered Institute of Public Finance and Accountancy, CIPFA) and reflect published Government advice.

1.2 The Strategy is an key element of the Councils Code of Financial Management, Annex A shows what is included in the Code of Financial Management in respect of Treasury Management.

2. TREASURY MANAGEMENT POLICY STATEMENT AND STRATEGY

2.1 The proposed Treasury Management Policy and 2014/15 Strategy is attached as Annex B and C respectively.

2.2 The investment strategy is to invest any surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest. The Council's borrowing strategy permits borrowing for cash flow purposes and funding current and future capital expenditure over whatever periods are in the Council's best interests.

3. LEGAL IMPLICATIONS

3.1 No direct, material legal implications arise out of this report.

4. RESOURCE IMPLICATIONS

4.1 The resource implications are noted within this report.

5 REASONS FOR THE RECOMMENDED DECISIONS

5.1 It is recommended that Overview and Scrutiny notes the report and recommends to Cabinet and then to Council the approval of:

- The Treasury Management Policy, Annex B.
- The Treasury Management Strategy, Annex C

6. LIST OF APPENDICES INCLUDED

Annex A: Code of Financial Management (extract)
Annex B Treasury Management Policy Statement
Annex C Treasury Management Strategy 2014/15
The Strategy also includes the following Appendices:
1 - Definition of Credit Ratings

2 - In-House Fund Management (If No Further Advance Borrowing)
3 - CIPFA Prudential Code For Capital Finance In Local Authorities; Prudential Indicators And Treasury Management Indicators For 2013/14

BACKGROUND PAPERS

Working papers in Financial Services

CONTACT OFFICER

Steve Couper, Assistant Director (Finance and Resources)
☎ 01480 388103

Clive Mason, Accountancy Manager
☎ 01480 388157

ANNEX A

Code of Financial Management (extract)

Treasury Management

- **Code of Practice**

All Treasury Management activities will be undertaken in accordance with the Council's annual Treasury Management Strategy, which includes its policies, objectives, approach to risk management and its prudential indicators. The Strategy will comply with the Code of Practice for Treasury Management and the Prudential Cost for Capital Finance, but published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and reflect any published Government advice.

- **Governance**

- The **Council**

.....shall have overall responsibility for Treasury Management and will formally approve the annual Treasury Management Strategy and receive an annual and mid-year report on treasury management activities.

- The **Cabinet**

.....will be responsible for the implementation and regular monitoring of treasury management activity.

- The **Overview and Scrutiny (Economic Well-being) Panel**

.....will be responsible for the scrutiny of treasury management.

- The **Responsible Financial Officer**

.....will establish treasury management practices for the operation of the function which will ensure compliance with the Strategy and create appropriate systems of monitoring and control.

- The **Treasury Management Advisory Group** (TMAG)

.....will be a formal liaison group between members and those officers responsible for treasury management.

ANNEX B

TREASURY MANAGEMENT POLICY STATEMENT

Definition
The Council defines its treasury management activities as:

- the management of the Council's investments, cash flows, 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.

Risk management
The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Value for money
The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy
The Council needs to balance a number of elements in its borrowing policy for funding capital expenditure:

- Utilising a mixture of borrowing periods to reduce the overall impact of changes in interest rates.
- Creating certainty by fixing borrowing for longer periods.
- Minimising the long term cost of any borrowing.
- Ensuring that short term costs are as low as possible.
- Using the Council's own reserves on a temporary basis

Clearly some of these elements can give contradictory answers and the decision on each borrowing decision will need to be based on balancing these elements, taking account of existing borrowing.

The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy
All investment decisions need to follow a risk assessment which takes account of the need to protect the principal sums invested from loss, ensuring

adequate liquidity so that funds are available to fund expenditure when needed, and the generation of investment income to support the provision of local authority services. Adequate weighting must be given to data reflecting the security of the investment.

Loans to Organisations

The Council may make loans to:

- local organisations, if this will allow the organisation to provide services that will further the Council's own objectives, and
- organisations where no service benefits are involved, but with the objective of earning a margin on the amounts loaned.

In either case loans will only be made where all risks have been considered and appropriate safeguards are in place.

Governance

The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

ANNEX C

TREASURY MANAGEMENT STRATEGY 2014/15

Treasury Management is:

- **Ensuring the Council has sufficient cash to meet its day-to-day obligations**
- **Borrowing when necessary to fund capital expenditure, including borrowing in anticipation when rates are considered to be low**
- **Investing any surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.**

This Strategy explains how Treasury Management will be carried out in Huntingdonshire. It meets the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (2011) and the Government's Guidance on Local Government Investments (2010)

BACKGROUND

Growth: The flow of credit to households and businesses slowly improved but was still below pre-crisis levels. The fall in consumer price inflation from the high of 5.2% in September 2011 to 2.1% in November 2013 helped consumers. There was hope it might allow real wage increases (i.e. after inflation) to slowly turn positive, improve confidence and aid future consumer spending.

Stronger UK growth data in 2013 (0.4% in Q1, 0.7% in Q2 and 0.8% in Q3) alongside a pick-up in property prices, mainly stoked by government initiatives to boost mortgage lending, lead markets to price in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. Unemployment was 7.4% in the three months to October 2013. However, with jobs growth picking up slowly, many employees working shorter hours than they would like and benefit cuts set to gather pace, economic growth was likely to only be gradual.

Monetary Policy: There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. On the probability of unemployment reaching the 7% threshold under the MPC's Forward Guidance, the November Inflation Report attached only a two-in-five chance to the rate having reached the 7% level by the end of 2014. The corresponding figures for the end of 2015 and 2016 were around three-in-five and two-in-three respectively. These forecasts brought forward market expectations of a bank rate rise, although the MPC repeatedly emphasised that the 7% threshold was not an automatic trigger for a rate rise.

A fragile economic recovery, subdued inflation and depressed bank lending resulted in the European Central Bank cutting the repo rate from 0.50% to

0.25%. ECB President Mario Draghi strengthened the Bank's pledge to keep interest rates low for as long as necessary and warned that it was too soon to say the euro region is out of danger.

In the US, following the clear momentum witnessed in its economy – despite the political impasse which resulted in a partial government shutdown during the quarter - the 'tapering' of asset purchases was announced by the Federal Reserve in December. Tapering will commence in January 2014 and with the Fed reducing its monthly purchases from $85bn to $75bn a month. Financial markets reacted in a predicatively ebullient manner with risk assets such as equities rallying toward higher levels whilst government bond prices reversed, leading to higher yields.

INTEREST RATE FORECASTS

Markets are still pricing in an earlier rise in rates than warranted under the MPC's forward guidance and the broader economic backdrop. The Council's treasury management adviser, Arlingclose, believes that the projected path for short term interest rates remain flat and it could be the third or fourth quarter of 2016 before official UK interest rates rise. Although the MPC left its policy stance unchanged at its January meeting, there is an increasing view that its forward guidance regime may need adjusting given the reasonably rapid improvements in the labour market as it is unlikely to raise rates until there is a sustained period of strong growth.

For the purpose of the Council's Medium Term Plan the following interest rates have been assumed but it is recognised that all assumptions about the speed with which rates will begin to rise is problematic.

	2014/15	2015/16	2016/17	2017/18	2018/19
	%	%	%	%	%
Temporary investments	0.58	0.58	0.55	0.95	1.43
PWLB 20 year borrowing (EOY)	3.39	3.64	4.08	4.25	4.50
Temporary borrowing	0.43	0.43	0.45	0.85	1.33

Against the background of low interest rates and reducing revenue and capital balances the Council has sought to maximise the returns from its investments whilst minimising the risks of investing with a borrower that is, or may become, unable to repay. It therefore adopted a strategy for 2013/14 that did not concentrate its investments with the Government's Debt Management Office which are effectively risk-free, as they are backed by the Government, but with a significantly below base interest rate, and instead concentrated on highly rated institutions and the larger Building Societies. At the same time investments in "liquidity accounts" which offer repayment the same day were maximised to further reduce risk.

The 2013/14 Strategy allowed for borrowing in anticipation of need to fund capital expenditure although that option has not so far been used this year. It is envisaged that a similar allowance is included in the 2014/15 Strategy.

CURRENT POSITION AND EXPECTED TREASURY PORTFOLIOS

The Council's position as at 31 December 2013 was:

INVESTMENTS & BORROWING		Principal Amount £m	Average Interest Rate %
Investments			
Short Term	- maturing by 31st March 2014	7.4	0.45%
	- maturing 2013/14	3.0	0.38%
Long Term	- maturing later	1.6	3.40%
Total		**12.0**	**0.83%**
Borrowing			
Short term	- maturing by 31st March 2014	0	0%
	- maturing 2013/14	0	0%
Long term	- maturing later	(11.5)	3.68%
Total		(11.5)	3.68%
Net Investments		**£0.5m**	**2.23%**

Expected changes in portfolio
According to current cash flow forecasts, net borrowing is expected to increase to £16.3m by 31st March 2014.

Budget implications
The budget for net interest in 2013/14 was £0.239m; the forecast outturn is £0.201m, a saving for £38,000. The small saving is attributable to a combination of low borrowing interest rates (especially between local authorities), delays in capital expenditure and higher than expected revenue reserves.

The budget for net interest in 2014/15 is £0.425m.

THE COUNCIL'S FINANCIAL STRATEGY

BORROWING STRATEGY

As noted above, the Council currently holds £11.5m of long-term loans; this is all borrowed from the Public Works Loans Board (PWLB).

Planned borrowing strategy for 2014/15 and future years

The table below shows the expected levels of reserves and the need for borrowing to fund capital expenditure over the MTP period.

	2014/ 2015 £m	2015/ 2016 £m	2016/ 2017 £m	2017/ 2018 £m	2018/ 2019 £m
Existing long term borrowing	**11.5**	**11.5**	**11.5**	**11.5**	**11.5**
available long term					
Revenue Reserves (EOY)	9.0	7.9	7.5	6.9	6.1
Provision for repaying loans (EOY)	4.4	6.4	8.6	11.1	13.9
Earmarked Reserves (EOY) ❶	1.9	1.6	1.6	1.6	1.6
available on a year by year basis	**15.3**	**15.9**	**17.7**	**19.6**	**21.6**
Cash Flow benefit average	**13.2**	**13.2**	**13.2**	**13.2**	**13.2**
fluctuates from day to day					
FUNDING REQUIRED					
Capital Expenditure					
Brought Forward	49.7	53.5	55.6	59.1	62.7
Capital Expenditure in Year	(3.8)	(2.1)	(3.5)	(3.6)	(3.1)
Carried Forward	**(53.5)**	**(55.6)**	**(59.1)**	**(62.7)**	**(65.8)**
Fixed Term Investment (EOY)	**(1.5)**	**(1.5)**	**(1.5)**	**(1.5)**	**(1.5)**
Total Required Funding	**(55.0)**	**(57.1)**	**(60.6)**	**(64.2)**	**(67.3)**
Excluding Use of Reserves **MAY BORROW**	**(43.5)**	**(45.6)**	**(49.1)**	**(52.7)**	**(55.8)**
Including Use of Reserves **MUST BORROW**	**(28.2)**	**(29.7)**	**(31.4)**	**(33.1)**	**(34.2)**
NEED FOR FURTHER BORROWING – FUNDING IN ADVANCE					
MAY BORROW A FURTHER	**(10.8)**	**(11.6)**	**(11.4)**	**(11.3)**	**(11.8)**
NEED FOR FURTHER BORROWING – LOANS TO ORGANISATIONS					
MAY BORROW A FURTHER	**(50.0)**	**(75.0)**	**(75.0)**	**(75.0)**	**(75.0)**

Notes

❶ includes specific earmarked reserves (e.g. Special Reserve, Repairs &Renewals Funds)

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Borrowing – Cash Flow

In addition to the fundamental movements described above there are day-to-day impacts due to the flow of funds into and out of the Council. For instance, the dates on which the County Council is paid its portion of the council tax and Business Rate receipts will be different to the days the money is physically received from Council Tax and Business payers. These cash flows will sometimes leave the Council with several million pounds to borrow, or invest, either overnight or for a few weeks depending on the next precept date.

Authorities are permitted to borrow short term for this purpose and all borrowing decisions will be made on the most economically advantageous rates for the period that is required to be covered. If rates are particularly high on a particular day then the sum may be borrowed overnight to see if rates are lower the following day for the remainder of the period.

Borrowing – No Funding Activity
The amount of capital borrowing up until March 2015 (i.e. up to an estimated £43.5M, "may borrow") will be dependent upon the actual levels of revenue spending which will determine the level of the Council's own reserves that can be used and the level of capital spending which will determine the total sum required. The period of borrowing will reflect the current and anticipated interest rate profile. If short term interest rates began to rise consideration would be given to whether long term rates were attractive enough to support long term borrowing. If rates remain low it is much more difficult to justify long term borrowing.

The **"MUST borrow"** amount represents the minimum amount that it is estimated that the Council will have to borrow if it uses its own reserves to fund part of the borrowing. The **"MAY borrow"** limit is based on using no internal funds for this purpose.

Borrowing – Funding in Advance
This additional limit is based on the agreement with our previous external auditors that it would be legitimate to borrow in advance to fund our 5 year published capital programme if market circumstances indicated that this was likely to be in the long term interests of the Council. This would require longer term borrowing rates to be at levels that appeared to be attractive when compared with rates that were expected over the remainder of that period. It would also need to take account of the difference between the borrowing rates and the currently, much lower, investment rates that would be received pending the use of the money for funding capital from sufficiently secure counterparties. A risk assessment will be carried out before undertaking any advance borrowing.

For example, if long term rates fell to 3.5% we would seriously consider increasing borrowing whilst if long term rates were 5.5% this would be extremely unlikely.

Currently low short-term rates reduce the likelihood of advance borrowing as the revenue budget would have to 'take the hit' of the borrowing rates being higher than the temporary investment rate in the short to medium term.

However, history has shown that violent fluctuations can happen and so there needs to be the freedom to act if circumstances significantly change.

Borrowing – Loans to Organisations
The amounts shown are indicative at this stage and any such loans to organisations would be subject to separate approval by Cabinet.

Borrowing - Profile

It is best practice to pool all funds and model future cash flow before determining the amounts that should be borrowed or invested and for how long. In doing this account will be taken of the provision that the Council is required to build up to fund the repayment of debt

The Council will be balancing two different aspects when deciding on the period it will borrow for:

- Stability.
  Avoid the risk of adverse market movements affecting the cost of borrowing. To do this the logical option is to borrow the money for as long as needed.

- Lowest Cost.
  Minimise the overall cost of borrowing which, at the present time, might result in very short borrowing because of the very low interest rates available. However, future rates may rise significantly meaning that it was better to have paid more initially and borrowed longer.

The logical result is to spread the risk by borrowing for a range of periods. However, given the Council's current financial position it may be that, until interest rates have returned to normal relativities or there is sufficient certainty that they will do so, the Council should use its revenue reserves and/or borrow short term for rates that are currently under 1%.

Any long term borrowing will tend to be from the Public Works Loans Board (PWLB) which is a Government Agency providing funds to local authorities at interest rates linked to the cost of central government borrowing. Commercial bodies have become less involved since the financial crisis and their products were generally for shorter periods and often include embedded options. The most common was a "Lender's Option Borrower's Option" deal, better known as a LOBO, where the lender retains an option to increase the interest rate after a number of years and the borrower has the right to repay if the new rate is not acceptable.

The Council will need to approve a prudential indicator for the 'authorised limit for external debt'. This will include forward funding of the MTP and Loans to Organisations but the three elements will be kept separate. With regard to 2014/15:

1. £85m No Forward Funding Activity
   - temporary borrowing for cash flow purposes (£25m)
   - long term existing borrowing (£10m)
   - borrowing to fund the forecast capital programme (£45m)
   - an allowance for other long-term liabilities, such as finance leases (£5m)
2. £11m Long term based on maximum borrowing in advance
3. £50m Long term borrowing to finance Long Term loans to Other Organisations: £50m

INVESTMENT STRATEGY
INVESTMENTS - CATEGORIES
The guidance on Local Authority Investments categorises investments as 'specified' and 'non-specified'.

Specified investments are expected to offer relatively high security and/or liquidity. They must be:

- in sterling (avoiding exchange rate fluctuations) **and**,
- due to be repaid within 12 months (minimising capital value fluctuations on gilts and CDs and minimising the period within which a counterparty might get into difficulty) **and**,
- **not** defined as capital expenditure in the capital finance regulations 2003 (e.g. equities and corporate bonds though there is current consultation on removing bonds from the capital constraint)) **and**,
- with a body that the Council considers is of high credit quality or with the UK Government or a local authority. (minimising the counterparty risk), this includes Money Market Funds where the Council has set minimum criteria.

These include time-deposits for up to 1 year with building societies and banks which the Council deems to have a high credit quality (see below), but it should be noted that early repayment, before the due date is rarely possible and may require a release fee.

No investment that counts as Capital expenditure will be undertaken, without Cabinet approval, as it effectively transfers revenue funds into capital when the investment is repaid which has significant impacts on the Council's financial flexibility.

Non-specified investments include longer deposits and other types of investment e.g. corporate bonds and equities.

The Council may use the following non-specified investments:

- Time Deposits of longer than 12 months with banks and building societies
- UK government bonds, supranational bank bonds
- loans to other local authorities and other organisations (further definition of the latter is shown below) over 12 months to maturity
- Corporate Bonds over 12 months to maturity, if returns are clearly better than time deposits, but such investments will only be made following a risk assessment and consultation on the proposed limits, procedures and credit ratings with the Treasury Management Advisory Group. Use would be limited to Bonds that could be held to maturity thus avoiding fluctuations in capital value.
- Pooled Property Funds

This is a new investment opportunity for the Council for 2014/15. It is intended to be a longer term vehicle (i.e. 5 years or longer), although money can be withdrawn with 1 month's notice. These types of investments are not "credit rated" because the investment is not in "cash", it is in a non-liquidity asset. Before any money is invested, this will be discussed and agreed at TMAG.

INVESTMENTS – HIGH CREDIT QUALITY

The term 'high credit quality' is used in the CLG guidance to encourage local authorities to monitor other measures of an institution's credit worthiness rather than just relying on credit ratings

CIPFA has issued guidance on possible sources of additional information in order to assess the credit worthiness of counterparties which are referred to below.

Whilst the Council will take some account of such additional information the main criteria for judging credit quality will be:

- Short term credit ratings (Definitions in Appendix A)
- Long-term credit ratings for any investment over 1 year. (Appendix A)
- The top 25 Building Societies by asset size irrespective of any credit rating they may hold subject to the comments below. Building societies have a much higher proportion of their funds covered by retail savings so are less at the risk of market volatility and their regulatory framework and insolvency regime means that the Council's deposits would be paid out before retail depositors. Experience in recent years includes a number of examples of the takeovers of weak societies by strong ones. However any Building Society with a rating of less than BBB will not be used and use will be suspended of Building Society with a "rating watch" warning pending consideration of further information of the potential impact.
- Reacting immediately to any "rating watch" warnings or informal comments from our advisors in relation to market concerns. Use of counterparties subject to such warnings/advice will be suspended pending consideration of further information of the potential impact.
- Credit Default Swap prices obtained from our advisors.
- The credit rating of the country of the institution. This must be AA or above (the exception being in respect of the domicile of Money Market Funds, see later section).

Financial statements and the financial press will not be systematically reviewed because the resources required are not available and it is expected that our advisors will make informal comments if they become aware of any significant items that affect our counterparty list. They also review our counterparty list every month.

Current account bank

Following a competitive tender exercise, in April 2010 the Royal Bank of Scotland Group (NatWest) was appointed to provide Banking Services in respect of the Council's current accounts. With a long term rating of "A" (January 2014) the bank is close to the bottom of the above credit rating criteria for this type of institution.

INVESTMENTS – SPREADING THE RISK
Credit quality can never be absolutely guaranteed so to further mitigate risks there is a need to spread investments in a number of ways:

- By counterparty, including any institutions that are linked in the same group.
- By country.

These limits need to be a practical balance between safety and administrative efficiency and need to cope with the uncertainty of the amount of borrowing in anticipation. A table is therefore included in Appendix B which shows the limits for different levels of forward borrowing.

INVESTMENTS – PERIODS
Once a time deposit is made there is no requirement for the borrower to repay until the end of the agreed period. Thus a borrower who has a high credit rating on the investment day could be in serious financial difficulties in the future. As a result significant use is made of liquidity accounts which currently give an attractive interest rate but also allow repayment of our investment the same day.

The Council will register with a selection of money market funds with AAA ratings which also allow same-day withdrawal of funds. The domicile for some of these funds can be in a low rated country; however as it is stipulated that the fund itself has to be Triple A, this is acceptable.

These funds will be used as appropriate taking account of comparative security and yields. During 2013/14, the Council used the following money market funds:

- Public Sector Deposit Fund, operated by Church's, Charities and Local Authorities, and
- Ignis Liquidity Fund, operated by Ignis Asset Management.

If during 2014/15, where it becomes advantageous, further funds may be used.

INVESTMENTS - MANAGEMENT
Taking account of the Credit Quality and Spreading the Risk sections above, Appendix B outlines the criteria and limits for making investments.

There may be limited occasions, based on detailed cash flow forecasts, where some investments of more than a year might be made that do not relate to borrowing in anticipation.

Risk of counterparty failure can also be minimised by shortening the period of any time deposit. At the current time, partly reflecting the current interest rate structure, time deposits are generally kept below one month. The criteria also differentiates the duration of investments based on credit rating e.g. the maximum duration of investments with building societies with no rating will be 1 month.

Advantage is also being taken of liquidity accounts which are offering competitive rates for money on call i.e. it can be called back the same or next day if there was any concern about the institution.

LOANS TO SUPPORT THE ACHIEVEMENT OF SERVICE OBJECTIVES
Opportunities will arise from time to time for the Council to further its objectives by making loans to local organisations or businesses. Such loans are considered to be investments as defined in this strategy. All such loans would require Cabinet approval and details of any risks pertaining to the loan would be included in the relevant Cabinet report. These loans would not be subject to the 5 year investment limit.

LOANS WITH SECURITY
The Localism Act potentially enables the Council to benefit from its low cost of borrowing to earn a margin by providing a loan to other bodies where no service benefits are involved. This option will be investigated but would only be implemented following legal and external audit confirmation of the statutory power, including consideration of the impact of the state aid regulations, and where security of the investment can be made through a legal charge on an adequate value of asset(s) to protect the Council from the possibility of default. If it is proposed to make such a loan, the Cabinet report requesting approval will include appropriate legal and valuation advice. These loans would not be subject to the 5 year investment limit.

POLICY ON USING FINANCIAL DERIVATIVES

Local authorities have previously made use of financial derivatives embedded in 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. lenders option/borrowers option (LOBO) loans).

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 Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) 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. It is unlikely that the Council will utilise standalone financial derivatives.

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. The Council is only likely to make limited use of embedded derivatives e.g. LOBOs

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.

ADVISORS

Arlingclose are the Councils appointed advisors. The Advisor carries out the following role:

- advice on investment decisions,
- notification of credit ratings and changes,
- general information on credit quality and informal comment on particular institutions,
- advice on borrowing and opportunities to borrow early
- economic data and interest rate forecasts
- advice and guidance on relevant policies, strategies and reports,
- accounting advice,
- reports on treasury performance,
- training courses.

The quality of the service is controlled by regular contact between the Advisors and officers. It should be noted that having external advisors does this negate the responsibility for Treasury Management decisions from the Council and its officers

MANAGEMENT

The Responsible Financial Officer and his staff will manage and monitor investments and borrowing.

The Treasury Management Advisory Group consists of four members and relevant officers. Members are kept informed of relevant issues and consulted on any significant issues.

The Council uses a cash flow model which is updated daily to forecast future cash flow movements to determine the maximum length for which any investment or borrowing shall be considered. The length of any investment would take account of actual and forecast interest rates over the loan period to ensure it optimises the Council’s position. At this time the Council is unlikely to invest for more than a year unless:

- further advance borrowing is undertaken, or
- “back-to-back” financing of a LoO loan (this would be subject to separate Cabinet approval).

REPORTING AND SCRUTINY

The CIPFA Code requires that the body responsible for approving the budget also receives at least two reports during the year on treasury management. Therefore the Council will receive a six month report on the performance of the funds and an annual report on the performance for the year.

The Code also requires the Council to identify the body that will be responsible for the scrutiny of treasury management to ensure that it receives the appropriate focus. This is the Overview & Scrutiny (Economic Well-being) Panel.

TRAINING

The needs of the Council's treasury management staff for training are assessed every six months as part of the staff appraisal process and additionally when the responsibilities of individual staff change.

The Code requires that Members charged with the governance of Treasury Management and those responsible for scrutiny have the necessary skills relevant to their responsibilities. Member training will be provided as necessary.

CHANGES TO THE STRATEGY

The strategy is not intended to be a strait-jacket but a definition of the upper limit of the level of risk that it is prudent for the Council to take in maximising the return on its net investments. Any changes that are:

- broadly consistent with this Strategy, and/or
- reduce or only minimally increase the level of risk, and/or
- supported by the Council's Treasury Management Advisors,

are delegated to the Responsible Financial Officer, after consultation with the Treasury Management Advisory Group. All other changes to the strategy must be approved by the full Council.

TREASURY MANAGEMENT AND PRUDENTIAL INDICATORS

The Council's Treasury Management and Prudential Indicators are attached at Appendix C. They are based on data included in the budget report and this Strategy. They set various limits that allow officers to monitor its achievement. These indicators must be approved by the Council and can only be amended by the Council.

The indicators are based on allowing the ability to borrow in advance if this becomes attractive. If it does not, the Council is likely to be significantly within many of the limits.

APPENDIX A

DEFINITION OF CREDIT RATINGS

	Rating	Definition	Examples of counterparties
Short term (Fitch)	**F1**	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.	Royal Bank of Scotland/NatWest (F1) Nationwide Building Soci0ety
	F2	Good intrinsic capacity for timely payment of financial commitments.	Leeds Building Society
	F3	The intrinsic capacity for timely payment of financial commitments is adequate.	Skipton Building Society
Long-term (Fitch)	**AAA**	Highest credit quality. 'AAA' ratings denote the **lowest expectation of credit risk.** They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.	Germany, Sweden, Switzerland, USA
	AA	Very high credit quality. 'AA' ratings denote **expectations of very low credit risk.** They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	United Kingdom AA+
	AA-		Standard Chartered Bank, HSBC Bank
	A	**High credit quality.** 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.	Nationwide Building Society
	A-		Leeds Building Society

The modifiers "+" or "-" may be appended to a rating to denote relative status within major rating categories.

IN-HOUSE FUND MANAGEMENT (IF NO FURTHER ADVANCE BORROWING)

Duration of investments	No investment shall be longer than 5 years. Maximum duration for a Building Society with no rating is 1 month.
Types of investments	Fixed term Deposits Deposits at call, two or seven day notice Corporate bonds Money market funds UK Government bonds and Supranational Bank bonds Loans to Organisations Pooled Property Funds
Credit Ratings	**Building Societies** All Building Societies with ratings of BBB or above. Building Societies with no ratings. (maximum duration 1 month) **Money Market Funds** AAA credit rating **Pooled Property Funds** (such funds are not credit rated as they are investments in non-liquid assets) **Local Authorities or UK Government** No rating required **Non-Building Societies** Short term rating F1 by Fitch or equivalent. Long-term rating of AA- by Fitch or equivalent if the investment is longer than 1 year. **Loans to Organisations** These will not require a specific credit rating but will be subject to individual approval by Cabinet.
Maximum limits per counterparty (group), country or non-specified category	F1+ or have a legal position that guarantees repayment for the period of the investment — £5M F1 — £4M Building Society with assets over £2bn in top 25 (Currently 10) — £5M Building Society with assets over £1bn if in top 25 (Currently 3) — £4M Building Society with assets under £1bn in top 25 — £3M Liquidity (Call) Account with a credit rating of F2 or with a legal position that guarantees repayment or a Building Society. — £5M BUT total invested with counterparty/group shall not exceed — £8M Money market fund AAA Credit rating — £4m **Limit for Non-specified investments** – £10M in time deposits more than one year – £5M in corporate bonds – £10M in any other types. – £10M Pooled Property funds – £15M in total **Country limits** – UK - unlimited – £5M in a country outside the EU – £10M in a country within the EU (excluding UK) – £20M in EU countries combined (excluding UK)

	– Country of Domicile for Money Market Funds – unlimited, providing the fund is AAA. Except for Money Market Funds, no investment will be made in country with a sovereign rating of less than AA. These limits will be applied when considering any new investment from 27 February 2014. Lower limits may be set during the course of the year or for later years to avoid too high a proportion of the Council's funds being with any counterparty. **Loans to Organisations** No limit in value or period.
Benchmark	LGC 7 day rate

INVESTMENT LIMITS FOR INCREASES IN ADVANCE BORROWING			
	Level of Borrowing in Anticipation		**Rating Constraints**
from	£5M	£11M	
to	£10M	£20M	
BUILDING SOCIETIES			
Assets over £2bn	£5M	£5M	
Assets over £1bn	£4M	£4M	
Rest of top 25 by assets	£3M	£3M	
BANKS & OTHER INSTITUTIONS			
F2+ or legal status	£5M	£5M	AA- if more than 1 year
F2	£4M	£4M	AA- if more than 1 year
LIQUIDITY ACCOUNTS			F2or legal status
Limit in liquidity account	£5M	£6M	
Limit with any other investments in institution	£8M	£9M	
POOLED PROPERTY FUND	£10M	£10M	
NON-SPECIFIED INVESTMENTS			
Time Deposits over 1 year in total	£20M	£30M	
Corporate Bonds in total	£5M	£8M	Not yet determined
TERRITORIAL LIMITS			
UK	Unlimited		
EU (excluding UK)	£20M	£20M	
EU Country (other than UK)	£10M	£10M	
Any other Country	£5M	£5M	

APPENDIX C

CIPFA PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT INDICATORS FOR 2013/14

The relevant Prudential and Treasury Management indicators that need to reflect the potential borrowing to finance funding in advance and loans to organisations have been amended. Where no requirement is shown, the indicator only reflects what is included in the Council's Medium Term Plan.

All decisions relating to loans to organisations will be subject to approval by the Cabinet. Where these decisions will affect the relevant prudential or treasury indicators noted below, other than Item 7: "the authorised limit for external debt, retrospective approval will sought of Council at either the mid-year or full year reporting periods.

PRUDENTIAL INDICATORS

1. Actual and Estimated Capital Expenditure

	2012/13 Actual £m	2013/14 Forecast £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Gross	8.3	14.4	5.4	4.0	4.3
Net	6.5	11.9	3.8	2.1	3.5

Where it is determined that loans to organisations are for capital purposes, this will be treated as capital expenditure and would be in addition to the current capital programme.

2. The proportion of the budget financed from government grants and council tax that is spent on interest and the provision for debt repayment.

2012/13 Actual	2013/14 Forecast	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
4%	7%	10%	13%	13%

Assuming no borrowing in advance or loans to organisations.

3. The impact of schemes with capital expenditure on the level of council tax

This calculation highlights the hypothetical impact on the level of Council Tax from changes from the previously approved MTP due to capital schemes (including their associated revenue implications).

The actual change in Council Tax will be significantly different due to revenue variations, spending adjustments and the use of revenue reserves.

	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Variation	£1.08	£1.90	(£0.96)
Cumulative	£1.08	£2.98	£2.02

4. The capital financing requirement.

This represents the estimated need for the Authority to borrow to finance capital expenditure less the estimated provision for redemption of debt (the MRP).

	31/3/13 Actual £m	2013/14 Forecast £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
No Funding Activity	**27.0**	**37.8**	**40.0**	**40.1**	**41.4**	**42.5**	**42.8**

In addition, this strategy makes provision for loans which may need to be treated as capital expenditure:

Loans to Organisations	**0.0**	**25.0**	**50.0**	**75.0**	**75.0**	**75.0**	**75.0**

5. Net borrowing and the capital financing requirement

In order to ensure that, over the medium term, net borrowing will only be for a capital purpose, the Authority should make sure that net external borrowing (borrowing less investments) does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current year and any specific decisions to borrow in advance or make loans to organisations.

The Council will explain the degree of borrowing and investment in its half-year and annual reports together with the reason for the movements so that Members can be assured that there is no borrowing for revenue purposes other than in the short term (cash flow).

5a. Gross and Net Debt

This indicator is intended to highlight the level of advance borrowing by limiting the variation between gross debt (borrowing) and net debt (borrowing less investments). The more borrowing in advance the higher the gross debt but there is no change in net debt because the borrowed sums will be invested pending them being needed to finance capital expenditure. Thus net debt as a proportion of gross debt falls as borrowing in advance occurs.

Unfortunately the position is complicated by the significant variations that the Council has to contend with relating to day-to-day cash flow which can cause major fluctuations in this proportion.

Guidance has not been issued on the practical use of this indicator and so there seems little point in setting one this year.

To achieve the equivalent result all advance borrowing will be reported to the Treasury Management Advisory Group and highlighted in the mid-year and end of year reports.

6. The actual external long-term borrowing at 31 March 2013

£10m

(the current level of PWLB borrowing is £11.5m)

7. The authorised limit for external debt.

This is the maximum limit for borrowing and is based on a worst-case scenario. It reflects borrowing to fund capital rather than using reserves and the three elements (No activity, borrowing in advance and loans) will be controlled separately.

	2013/14 Limit £m	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Short term	20	25	25	25
Long term	48	55	57	61
Other long-term liabilities (leases)	5	5	5	5
Total - No Funding Activity	**73**	**85**	**87**	**91**
Long Term based on the maximum borrowing in advance	14	11	12	11
Long term borrowing to finance Long Term Loans to Organisations	25	50	75	75

8. The operational boundary for external debt.

This reflects a less extreme position. Although the figure can be exceeded without further approval it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded.

	2013/14 Limit £m	2014/15 Limit £m	2015/16 Limit £m	2016/17 Limit £m
Short term	15	20	20	20
Long term	48	55	57	61
Other long-term liabilities (leases)	5	5	5	5
Total – No Funding Activity	**68**	**80**	**82**	**86**
Plus any long term borrowing in advance	14	11	12	11
Plus any long term borrowing to finance long term loans to organisations	25	50	75	75

9. Adoption of the CIPFA Code

The Council has adopted the 2011 edition of the CIPFA Treasury Management Code of Practice.

TREASURY MANAGEMENT INDICATORS

10. Exposure to interest rate risk as a proportion of net investments.

This indicator is set to control the Council's exposure to interest rate risk. Investments of less than 12 months count as variable rate.

If the Council does not borrow in advance it is quite possible that all investments will be of less than a year's duration and hence count as "variable rate".

		2014/15 Limits		2015/16 Limits		2016/17 Limits	
		Max	Min	Max	Min	Max	Min
Borrowing Longer than 1 year	Fixed	100%	75%	100%	75%	100%	75%
	Variable	25%	0%	25%	0%	25%	0%
Investments Longer than 1 year	Fixed	100%	100%	100%	100%	100%	100%
	Variable	0%	0%	0%	0%	0%	0%

11. Borrowing Repayment Profile

The proportion of borrowing in place during 2014/15 that will mature in successive periods. This indicator is set to control the Council's exposure to refinancing risk.

The Council has £11.5M long term borrowing but the uncertainty on whether any forward borrowing will take place and the potential for short term borrowing to be the most attractive option results in the limits set out below.

Funding capital schemes	Upper limit	Lower limit
Under 12 months	92%	0%
12 months and within 24 months	92%	0%
24 months and within 5 years	92%	0%
5 years and within 10 years	93%	1%
10 years and above	100%	7%

This may be affected by any Funding in Advance or Loans to Organisations.

12. Investment Repayment Profile

Limit on the value of investments that cannot be redeemed within 364 days i.e. by the end of each financial year. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. These limits need to allow for borrowing in advance.

The uncertainty about borrowing in advance results in higher limits than would otherwise be required.

	2014/15 £m	2015/16 £m	2016/17 £m
Limit on investments over 364 days as at 31 March each year.	**32.7**	**34.0**	**37.7**

This may be affected by any Funding in Advance or Loans to Organisations.