Appendix 2

DRAFT

Treasury Management Strategy Statement and Investment Strategy 2015/16 to 2017/18

Contents

Annexes

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Investment Strategy as required under the Communities and Local Government (CLG) Department's Investment Guidance and the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

1.2 CIPFA has defined Treasury Management as:
"the management of the organisation'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."

1.3 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are integral elements of treasury management activities and include Credit and Counterparty Risk, Liquidity Risk, Market or Interest Rate Risk, Refinancing Risk and Legal and Regulatory Risk.

1.4 The strategy takes into account the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators and the outlook for interest rates. Subsequent changes to the revenue budget and capital programme will require adjustments to the TMSS and Prudential Indicators.

1.5 The purpose of this report is to propose:

- Treasury Management Strategy - Borrowing in Section 4, Investments in Section 5
- Prudential Indicators – these are detailed throughout the report and summarised in Annex 2
- MRP Statement – Section 10

1.6 The strategy has been developed in consideration of economic and interest rate forecasts detailed in annex 3.

2. CIPFA Treasury Management Code of Practice

2.1 Adoption of the CIPFA Treasury Management Code of Practice is one of the Prudential Indicators. The Council originally adopted the Code of Practice in May 2002. Revisions to the Code in 2009 and 2011 have been reflected in updated versions of all policies and procedures.

3. Balance Sheet and Treasury Position

3.1 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with Balances and Reserves, are the core drivers of Treasury Management activity. The estimates for each pool, based on the current proposed Revenue Budget and Capital Programmes, are:

Table 1a: Treasury Position – General Fund

	31/03/2014 Actual £'000	31/03/2015 Estimate £'000	31/03/2016 Estimate £'000	31/03/2017 Estimate £'000	31/03/2018 Estimate £'000
General Fund CFR	272,753	282,158	282,235	274,451	278,378
Less: Share of existing External Debt & Other Long Term Liabilities	154,927	147,684	139,960	130,990	121,925
Internal Borrowing	117,826	134,474	134,474	134,474	134,474
Cumulative Net Borrowing Requirement	0	0	7,801	8,987	21,979

Table 1b: Treasury Position – HRA

	31/03/2014 Actual £'000	31/03/2015 Estimate £'000	31/03/2016 Estimate £'000	31/03/2017 Estimate £'000	31/03/2018 Estimate £'000
HRA CFR	271,096	271,096	283,303	313,656	305,348
Less: Share of Existing External Debt & Other Long Term Liabilities	206,646	207,981	191,453	182,483	173,705
Internal Borrowing	64,450	73,115	73,115	73,115	73,115
Cumulative Net Borrowing Requirement	0	0	28,735	58,058	58,528

3.2 The tables above show how the Council's capital requirement is funded currently and how it is expected to be funded in the coming years. Due to

the differential between short and long term interest rates (discussed in more detail in section 4), the Council has maximised the amount of internal borrowing that can be done. As short term interest rates are forecast to remain below 2% for the next three years, it is anticipated that a significant level of internal borrowing will continue, with the only reduction expected reflecting the planned movement in reserves.

3.3 Ensuring that gross external debt does not exceed the CFR over the medium term is a key indicator of prudence. There has been no difficulty meeting this requirement in 2014-15 to date, nor are there any difficulties envisaged for future years, as the levels of internal borrowing in tables 1a and 1b above demonstrate.

3.4 It is a requirement for the HRA CFR to remain with the limit of indebtedness or "debt cap" set by the DCLG at the time of the implementation of self-financing. The table below shows the current expected level of the HRA CFR and the debt cap. Any decision by the Council to undertake new borrowing for housing will cause the future years' debt predictions for the HRA debt pool to increase.

Table 2: HRA Debt Cap

	31/03/2014 Actual £'000	31/03/2015 Estimate £'000	31/03/2016 Estimate £'000	31/03/2017 Estimate £'000	31/03/2018 Estimate £'000
HRA CFR	271,096	271,096	283,303	313,656	305,348
HRA Debt cap	327,538	327,538	327,538	327,538	327,538
Headroom	56,442	56,442	44,235	13,882	22,190

3.5 Table 3 below shows proposed capital expenditure over the coming three financial years. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and housing rent levels.

Table 3: Capital Expenditure

	2013/14 Actual	2014/15 Approved	2014/15 Projected Out-turn	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
General	41,510	46,563	78,489	25,143	32,500	27,955
HRA	32,074	63,310	48,851	68,504	82,847	55,668
Total	73,584	109,873	127,340	93,647	115,347	83,623

3.6 Capital expenditure is expected to be financed or funded as follows:

Table 4: Capital Financing

	2013/14 Actual £'000	2014/15 Approved £'000	2014/15 Projected Out-turn £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Capital receipts	1,009	9,269	15,341	12,769	27,026	23,271
Other grants & contributions	18,534	9,896	11,165	16,180	4,470	5,975
Government Grants	12,566	32,307	31,393	15	4,000	3,000
Reserves / Revenue contributions	28,981	40,044	36,625	40,675	45,853	44,180
Total Financing	61,090	91,516	94,524	69,639	81,349	76,426
Borrowing	12,494	18,357	32,816	24,008	33,998	7,197
Total	73,584	109,873	127,340	93,647	115,347	83,623

3.7 As an indicator of affordability the table below shows the incremental impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme (based on the interest cost of capital receipts and borrowing applied to capital expenditure) with the number of homes paying council tax (GF) and the number of rented properties (HRA). The General Fund ratio peaks in the current year as the allocation of capital receipts and borrowing to capital expenditure of £48 million is twice that included in the pre-year projection (£26 million).

Table 5: Incremental Impact of Capital Investment Decisions

	2013/14 Actual £'000	2014/15 Approved £'000	2014/15 Projected Out-turn £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Increase in Band D Council Tax	11.59	17.19	43.66	16.42	9.85	24.22
Increase in Average Weekly Housing Rents	0.09	0.17	0.09	1.45	3.54	0.38

3.8 The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the

revenue budget required to meet borrowing costs. The ratio is based on debt costs less investment income.

3.9 For the General Fund, interest costs are expected to fall as old 'expensive' debt matures with the finance cost ratio to revenue remaining below 2013/14 levels despite decreasing revenues. There is a similar impact for HRA were the impact of retiring debt exceeds the cost of additional new debt.

Table 6: Ratio of Financing Costs to Net Revenue Stream

	2013/14 Actual %	2014/15 Approved %	2014/15 Projected Out-turn %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
General Fund	2.38	2.16	1.93	1.93	1.94	1.98
HRA	11.89	11.13	9.91	9.28	9.92	10.12

4. Borrowing Strategy

4.1 A breakdown of the Council's current and expected external borrowing plus other long-term liabilities is shown in Annex 1. This is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit. Debt (excluding leases) is projected at £294 million at the year end, a decrease of £13 million during the year. No new borrowing, including temporary borrowing, has been required. It is anticipated that new borrowing of £20 million, including £11 million of maturities will be required next year. Borrowing to pre-fund future year requirements will be considered when this will result in interest savings.

4.2 The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit). The Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

Table 7: Authorised Limit for External Debt

	2013/14 Actual Debt £'000	2014/15 Approved £'000	2014/15 Projected Out-turn £'000	2015/16 Authorised Boundary £'000	2016/17 Authorised Boundary £'000	2017/18 Authorised Boundary £'000
Borrowing	307,159	489,334	294,065	428,325	475,280	495,477
Other Long-term Liabilities	54,414	71,745	51,600	67,919	66,177	61,347
Total	361,573	561,079	345,665	496,244	541,457	556,824

4.3 The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit. The Operational Boundary and Authorised Limit apply at the total level. The limits compare with existing gross debt of £346 million and projected three year debt financed capital expenditure of £59 million and provides scope for variations in capital expenditure, funding sources and reserves.

Table 8: Operational Boundary for External Debt

	2013/14 Actual Debt £'000	2014/15 Approved £'000	2014/15 Projected Out-turn £'000	2015/16 Authorised Boundary £'000	2016/17 Authorised Boundary £'000	2017/18 Authorised Boundary £'000
Borrowing	307,159	359,099	294,065	378,325	425,280	445,477
Other Long-term Liabilities	54,414	66,745	51,600	61,745	57,545	53,345
Total	361,573	425,844	345,665	440,070	482,825	498,822

4.4 The Chief Financial Officer has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Corporate Committee.

4.5 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast provided in Annex 3 indicates that an acute difference between short and longer term interest rates is expected to continue into 2017. This difference creates a "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments because of the

difference between what is paid on the borrowing and what is earned on the investment.

4.6 This "cost of carry" has been a feature of money markets since 2009-10 and by essentially lending its own surplus funds to itself (i.e. internal borrowing) the Council has minimised borrowing costs and reduced overall treasury risk by reducing the level of its external investment balances. As this position is expected to continue throughout 2015-17, there are no plans to replace this internal borrowing with external borrowing. When the 2014-15 strategy was prepared it was projected that new external borrowing of approximately £34 million was required in the year to refinance maturing debt and a reduced level of internal borrowing. Currently, no new debt in the current financial year is anticipated.

4.7 The Council will adopt a flexible approach to this borrowing in consultation with its treasury management advisers, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk;
- Borrowing source.

4.8 In conjunction with advice from Arlingclose Ltd, its treasury management adviser, the Council will keep under review the following borrowing options:

- PWLB loans
- Municipal Bond Agency
- Borrowing from other local authorities
- Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
- Borrowing from the Money Markets
- Capital markets (stock issues, commercial paper and bills)
- Structured finance
- Leasing

4.9 One new borrowing route may become available next year, the Municipal Bond Agency ("MBA"). This is a vehicle initiated by the Local Government Association and supported by Council's to collectively raise debt at rates below the PWLB. The dilemma in considering the MBA is that initially its rates and flexibility may be inferior to the PWLB and require joint and several guarantees covering borrowing by other councils but if successfully launched will be in a good position to save on the PWLB margin of 80b.p. charged above the Government's cost of borrowing. Borrowing from the MBA will require pre-approval from Legal and the Corporate Committee.

4.10 Looking forward, the Council's capital plans currently remain uncertain as to the value and timing of expenditure. However, based on debt maturities

and project bids there is an aggregate borrowing requirement of £77 million in the next three years. With long term rates anticipated to increase by 100-130 bps in the next 36 months, it may be economic to lock in longer term borrowing when greater capital expenditure visibility is available, even if this does entail a short term cost. In particular, longer term rates have demonstrated volatility and interest costs can be mitigated by timing the acquisition of new debt.

4.11 Discussions are currently being held with Arlingclose on forward starting debt that enable new borrowing commencing in up to three years to be agreed at current interest rates thus allowing low cost short term debt to be used for the next three years without missing the opportunity to lock into low cost long term borrowing. If the loan structure is suitable this is an attractive opportunity to minimise interest costs.

4.12 The "cost of carry" discussed above has resulted in recent preference for shorter dated and variable rate borrowing. These types of borrowing inject volatility into the debt portfolio in terms of interest rate risk, however this is counterbalanced by its affordability and alignment of borrowing costs with investment returns. In practice relatively little new borrowing has been required in recent years. At present short term (weekly) local authority rates of 0.5% compare with 10-50 year PWLB rates of 2.4% to 3.1%.

4.13 The intention for 2015-16 is that any new borrowing will be short term debt. Thereafter there will be a switch to longer dated maturities. The Council's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference between variable rate and longer term borrowing costs. A narrowing in the spread between 3 month and 20 year rates to under 2% will result in a review of the borrowing strategy in conjunction with the Council's treasury management advisers to determine whether the exposure to shorter dated and variable rates is maintained or altered.

4.14 The Council has £125m of loans which are LOBO loans (Lender's Options Borrower's Option) and all of them are in their call periods. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion. As LOBOs currently make up 42% of the total external debt portfolio, this is a significant risk. However, at the present time the interest rates on LOBO loans of 4.7% to 4.75% are above PWLB rates making any opportunities to repay both unlikely and financially beneficial. Any LOBO called will be discussed with the Council's treasury advisers prior to the acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted. One lender has offered premature repayment but at a 60% premium, which is considered excessive and has been declined.

4.15 The Council's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs. The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring, although occasional opportunities arise. The rationale for undertaking any debt rescheduling would be one or more of the following:

- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Align long term cash flow projections and debt levels
- Changing the maturity profile of the debt portfolio.

In the short term gains would accrue from replacing long term debt with shorter maturities, but from a longer term perspective this would not add value. Borrowing and rescheduling activity will be reported to Corporate Committee as part of the quarterly monitor reports.

4.16 The following Prudential Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

4.17 The Council's existing level of fixed interest rate exposure is 98% and variable rate exposure is 2%, however it is recommended that the limits in place for 2014/15 are maintained in future to retain flexibility. At present variable rates from the PWLB compare unfavourably with short term loans from local authorities due to the additional margin charged over gilts. If LOBO loans are treated as variable, the current variable allocation is 44%.

Table 9: Fixed and Variable Interest Rate Exposure

	2014/15 Approved %	2014/15 Actual %	2015/16 Upper Limit %	2016/17 Upper Limit %	2017/18 Upper Limit %
Upper Limit for Fixed Interest Rate Exposure	100	98	100	100	100
Upper Limit for Variable Interest Rate Exposure	40	2	40	40	40

4.18 The Council is required to set limits on the percentage of the portfolio maturing in each of the periods set out in the table below. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt. The limits have been set to reflect the current debt portfolio, and to allow enough flexibility to enable

new borrowing to be taken for the optimum period. The limits apply to the combined General Fund and HRA debt pools.

4.19 The maturity range has been applied to LOBO loans (see 4.12 above) based on their contractual maturity date. The column on the right hand side represents the maturity structure based on the next date that the lender is able to reset interest rates.

	Lower Limit	Upper Limit	31-Mar-15	31-Mar-15
	%	%	%	LOBO adjusted %
under 12 months	0%	40%	4%	46%
12 months & within 24 months	0%	35%	4%	4%
24 months & within 5 years	0%	35%	11%	11%
5 years & within 10 years	0%	35%	13%	13%
10 years & within 20 years	0%	35%	0%	0%
20 years & within 30 years	0%	35%	8%	4%
30 years & within 40 years	0%	35%	22%	9%
40 years & within 50 years	0%	50%	13%	13%
50 years & above	0%	50%	25%	0%

4.20 The average interest rate on debt will decline in 2015-16 from 5.39% to 5.12%, with annual interest costs falling by £1.0 million to £15.3 million.

5. Investment Policy and Strategy

5.1 Guidance from the Communities and Local Government Department (CLG) on Local Government Investments in England requires that an Annual Investment Strategy be set.

5.2 The Council investments represent income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £10 and £86 million. Cash balances will continue to vary depending on the timing of cashflows, although peak balances should be lower next year as borrowing is postponed.

5.3 The Council's investment priorities are, in this order:

- security of the invested capital;
- liquidity of the invested capital; and
- an optimum yield that is commensurate with security and liquidity.

5.4 Arlingclose, the Council's treasury management advisers, has a way of scoring the level of credit risk the Council is taking. This measure scores credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0 - 2
Target score	AA to A+	Score 3 - 5
Below target	Below A+	Score over 5

The quarterly scores during 2014-15 have been within the range 3.7 to 4.9, which is within the target score. For the next three years the target will remain 3 to 5.

5.5 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Instruments proposed for the Council's use within its investment strategy are contained in Annex 4 and the list of proposed counterparties is shown in Annex 5. In keeping with the strategy of maintaining low investment balances while internally borrowing, it is proposed that all investments will have a maturity of less than one year during 2014/15. The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Investment activity will be reported to Corporate Committee as part of the quarterly reports.

5.6 Although the UK economy has reported strong GDP growth in recent quarters this has had a mixed impact on the UK banking sector. Bank credit ratings have continued to weaken with RBS / NatWest dropping below the minimum rating of A-. UK Banks have suffered losses due to compensation payments and regulatory fines with the Government's determination to share the cost of future rescues with unprotected creditors (bail in risk) also pushing down on credit ratings. Banking share prices have declined in the year (RBS is the exception) but the cost of incurring against banking defaults (CDS spreads) has fallen, in the case of RBS by 50%. The combination of weaker rated banks and Government's requiring creditors to contribute towards the cost of supporting banks pose considerable investment challenges. Constructing an investment portfolio in these circumstances will consider the following approaches to risk mitigation:

a) Continuing to minimise investment balances through delaying new borrowing.
b) Investing with the UK Government backed DMO and other UK local authorities.
c) Maintaining a diversified investment portfolio to spread risk, including money market & enhanced cash funds.
d) Including high quality overseas banks in the counterparty list.
e) Investing in 'covered deposits' which offer an additional layer of protection in the form of backing assets.

f) Buying tradable instruments such as commercial paper that offer access to non financial counterparties and can improve liquidity.

5.7 Reference was made in 5.6 to bail in risk. The UK (and other) Governments have legislated that when a bank's capital ratio falls below minimum levels and the bank is not able to raise fresh capital that part of the non protected customer deposits will be converted into share capital. Protected deposits include retail and non financial business customers. Local authorities deposits are not protected and will therefore suffer a greater loss than if the bail in was spread across all deposits. Bail in increases the risk to the Council from bank deposits. An appropriate response is to reduce reliance on bank deposits, lower exposures to the weaker banks and increase diversification of bank deposits. For this reason three overseas banks have been included within the counterparty list (appendix 5)

5.8 The Counterparty policy (appendix 4) incorporates the above options. Consideration was given to reducing the minimum credit quality below A- to facilitate access to a wider range of UK banks and building societies, but this was rejected as increasing the default risk. No investments will have duration of more than 12 months and in practice durations of more than 3 months are unlikely, unless borrowing to support capital expenditure is taken early to capture favourable rates.

5.9 With all investments the Council makes there is a risk of default, so the proposed list of investments is prepared to minimise this risk by being selective about the counterparties to be used. It is proposed to continue to apply a minimum long term credit rating of A-, which is described as "high credit quality" by the rating agencies.

5.10 The Council treasury advisor recommends maximum maturities for individual counterparties and although these are only advisory, they are being followed.

5.11 All counterparties on the list are subjected to continual monitoring, in conjunction with the Council's treasury management advisers, to ensure that they continue to meet the high standard set. The range of information used to determine creditworthiness is:

- Credit ratings (long and short term and credit rating watches
- Credit Default Swaps (where quoted)
- Sovereign support mechanisms/potential support from a well-resourced parent institution
- Share prices
- Macro-economic indicators
- Corporate developments, news and articles, market sentiment.

5.12 If the monitoring reveals any concern about an institution's creditworthiness, it will be removed from the lending list with immediate effect. In normal circumstances a credit rating downgrade below the minimum criteria will not result in existing term deposits being recalled

prior to contractual maturity. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure). Current conditions are not considered to be "significant stress".

5.13 In order to diversify the investment portfolio, investments will be placed with a range of approved investment counterparties. Maximum investment levels with each counterparty are set out in Annex 5 will ensure prudent diversification is achieved.

5.14 Money Market Funds (MMFs) and Enhanced Cash Funds (ECFs) provide good diversification of underlying counterparty but may themselves be subject to withdrawal restriction. The Council will therefore seek to diversify any exposure by utilising more than one MMF or ECF unless there are significant instant access funds from other sources. The Council will also restrict its exposure to MMFs and ECFs with lower levels of funds under management and will not exceed 2% of the net asset value of the MMF or ECFs.

5.15 The Council is required to set an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. Given the current interest rate environment, the Council will not make investments for more than 364 days (see comments in 5.6 above).

5.16 The average rate of interest earned on investments during 2014-15 is projected at 0.35%. For 2015-16 the average rate is expected to increase to 0.5% reflecting forecast changes in base rates and a continuity emphasis on security and liquidity. Interest earned in 2014-15 is projected at £130,000, with similar levels in 2015-16.

6. Use of Financial Instruments for the Management of Risks

6.1 The CIPFA Treasury Management Code of Practice requires the Council to state if and how it will use financial instruments, such as derivatives. Currently, local authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the Council does not intend to use derivatives. Should this position change, the Council may develop a detailed and robust risk management framework governing the use of derivatives, but such a change in strategy would require full Council approval.

7. Housing Revenue Account Self-financing

7.1 Local authorities are required to recharge interest expenditure and income attributable to the HRA in accordance with Determinations issued by the Department for Communities and Local Government.

7.2 The Determinations do not set out a methodology for calculating the interest rate to use in each instance. The Council is therefore required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA Treasury Management Code of Practice recommends that authorities present this policy in the annual Treasury Management Strategy Statement.

7.3 On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long term loans borrowed will be assigned in to one pool or the other taking into consideration projected capital expenditure and reserves. Interest payable and other costs/income arising from long term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account.

7.4 Differences between the value of the HRA loan pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured periodically and interest transferred between the General Fund and HRA at the net average rate earned by the Council on its portfolios of treasury investments and short term borrowing.

8. Outlook for Interest Rates

8.1 The interest rate forecast provided by the Council's treasury management adviser, Arlingclose Ltd, is attached at Annex 3. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

8.2 This interest rate forecast shows that UK base rate is forecast to remain at 0.5% until quarter 3, 2015, rising slowly in 0.25% instalments thereafter. This will mean that short term rates remain significantly lower than long term rates throughout 2014/15 and beyond. As discussed in section 4, for this reason it is anticipated that cash balances will kept at a minimum throughout the financial year as the "cost of carry" will be significant for any borrowing taken before capital expenditure is incurred.

9. Balanced Budget Requirement

9.1 The Council complies with the provisions of Section 32 of the Local Government Finance Act 1992 to set a balanced budget.

10. MRP Statement

10.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

10.2 The four MRP options available are:

Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

10.3 MRP in 2014/15: The guidance states Options 1 and 2 may be used only for capital expenditure originally incurred when government support was available. Methods of making prudent provision for self financed expenditure include Options 3 and 4. There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

10.4 It is a requirement for Council to approve the MRP statement before the start of the financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Council at that time.

10.5 It is proposed the Council will continue to apply Option 1 (charge 4% per annum over 25 years) in respect of capital expenditure originally incurred when government support was available and Option 3 (charge over the life of the asset) in respect of all other capital expenditure funded through borrowing. MRP in respect of leases and PFI (Private Finance Initiative) schemes brought onto the Balance Sheet under the IFRS (International Financial Reporting Standards) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

11. Capital Expenditure

11.1 The evaluation of capital expenditure projects incorporates the cost of financing. This comprises two elements (a) the recovery of purchase costs through MRP and (b) interest. Where capital expenditure is low and no specific borrowing is required the interest cost allocated to the project will be the average cost of the Council's debt portfolio. This method will be used even if no borrowing takes place in the year as capital expenditure reduces the ability to repay debt.

11.2 For projects incurring a high initial cost for which specific debt financing is arranged, then the interest cost used will be the average rate on the specific debt.

12. Other Options Considered

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

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

13. Other Issues

Monitoring & Reporting

13.1 Corporate Committee will receive quarterly reports on treasury management activity and performance. This will include monitoring of the prudential indicators.

13.2 It is a requirement of the Treasury Management Code of Practice that an outturn report on treasury activity is produced after the financial year end, no later than 30th September. This will be reported to Corporate Committee, shared with the Cabinet member for Resource & Culture and then reported to full Council. Overview and Scrutiny Committee will be responsible for the scrutiny of treasury management activity and practices.

13.3 Officers monitor counterparties on a daily basis with advice from the Council's treasury management advisers to ensure that any creditworthiness concerns are addressed as soon as they arise. Senior

management hold monthly meetings with the officers undertaking treasury management to monitor activity and to ensure all policies and procedures are being followed.

Training

13.4 CIPFA's Treasury Management Code of Practice requires the Chief Financial Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

13.5 Given the significant amounts of money involved, it is crucial members have the necessary knowledge to take treasury management decisions. Regular training sessions are arranged for members to keep their knowledge up to date.

Treasury Advisor

13.6 The CLG's Guidance on local government investments recommends that the Investment Strategy should state:

"Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and how the quality of any such service is controlled."

13.7 The Council has appointed Arlingclose Limited as their treasury advisor, to provide information and advice about the types of investment and borrowing the Council should undertake and the counterparties that should be used. Quarterly service review meetings take place to monitor the service and the appointment is formally reviewed in accordance with the Council's Contract Standing Orders.

ANNEX 1

Detail of Treasury Position

A: General Fund Pool

	31-Mar-15 Projected £'000	31-Mar-16 Estimate £'000	31-Mar-17 Estimate £'000	31-Mar-18 Estimate £'000
Existing External Borrowing commitments:				
PWLB	53,803	50,467	45,882	41,395
Market loans	42,281	42,281	42,281	42,281
Local Authorities	0			
Total External Borrowing	96,084	92,748	88,163	83,676
Long Term Liabilities	51,600	47,213	42,827	38,249
Total Gross External Debt	147,684	139,961	130,990	121,925
CFR	282,158	282,235	274,451	278,378
Internal Borrowing	134,474	134,474	134,474	134,474
Cumulative Borrowing requirement	0	7,800	8,987	21,979

B: HRA Pool

	31-Mar-15 Projected £'000	31-Mar-16 Estimate £'000	31-Mar-17 Estimate £'000	31-Mar-18 Estimate £'000
Existing External Borrowing commitments:				
PWLB	115,262	108,734	99,764	90,989
Market loans	82,719	82,719	82,719	82,716
Local Authorities				
Total External Borrowing	197,981	191,453	182,483	173,705
CFR	271,096	283,303	313,656	305,348
Internal Borrowing	73,115	73,115	73,115	73,115
Cumulative Borrowing requirement	0	18,735	58,058	58,528

C: Security Measure

		2015-16	2015-16	2015-16
Above target	AAA to AA+	Score 0 - 2	Score 0 - 2	Score 0 - 2
Target score	AA to A+	Score 3 - 5	Score 3 - 5	Score 3 - 5
Below target	Below A+	Score over 5	Score over 5	Score over 5

ANNEX 2

Summary of Prudential Indicators

No.	Prudential Indicator	2015/16	2016/17	2017/18
CAPITAL INDICATORS				
1	Capital Expenditure	£'000	£'000	£'000
	General Fund	25,143	32,500	27,955
	HRA	68,504	82,847	55,668
	TOTAL	93,647	115,347	83,623
2	Ratio of financing costs to net revenue stream	%	%	%
	General Fund	1.93	1.94	1.98
	HRA	9.28	9.92	10.12
3	Capital Financing Requirement	£'000	£'000	£'000
	General Fund	282,235	274,451	278,378
	HRA	283,303	313,656	305,348
	TOTAL	565,538	588,107	583,726
4	Incremental impact of capital investment decisions	£	£	£
	Band D Council Tax	16.42	9.85	24.22
	Weekly Housing rents	1.45	3.54	0.38

No.	Prudential Indicator	2015/16		2016/17		2017/18	
TREASURY MANAGEMENT LIMITS							
5	Borrowing limits	£'000		£'000		£'000	
	Authorised Limit	496,244		541,457		556,824	
	Operational Boundary	440,070		482,825		498.822	
6	HRA Debt Cap	£'000		£'000		£'000	
	Headroom	44,235		13,882		22,190	
7	Upper limit – fixed rate exposure	100%		100%		100%	
	Upper limit – variable rate exposure	40%		40%		40%	
8	Maturity structure of borrowing (U: upper, L: lower)	L	U	L	U	L	U
	under 12 months	0%	40%	0%	40%	0%	40%
	12 months & within 2 yrs	0%	35%	0%	35%	0%	35%
	2yrs & within 5 yrs	0%	35%	0%	35%	0%	35%
	5 yrs & within 10 yrs	0%	35%	0%	35%	0%	35%
	10 yrs & within 20 yrs	0%	35%	0%	35%	0%	35%
	20 yrs & within 30 yrs	0%	35%	0%	35%	0%	35%
	30 yrs & within 40 yrs	0%	35%	0%	35%	0%	35%
	40 yrs & within 50 yrs	0%	50%	0%	50%	0%	50%
	50 yrs & above	0%	50%	0%	50%	0%	50%
9	Sums invested for more than 364 days	0		0		0	
10	Adoption of CIPFA Treasury Management Code of Practice	√		√		√	

ANNEX 3

Arlingclose's Economic and Interest Rate Forecast

	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18
Base Rate	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75
3 month LIBID	0.75	0.90	1.05	1.20	1.35	1.50	1.60	1.70	1.80	1.90	2.00	2.10
1 year LIBID	1.05	1.20	1.35	1.50	1.65	1.80	1.95	2.10	2.20	2.30	2.40	2.50
5 yr gilt	1.60	1.75	1.90	2.00	2.15	2.25	2.35	2.45	2.50	2.55	2.60	2.60
10 yr gilt	2.10	2.20	2.30	2.40	2.50	2.60	2.70	2.75	2.80	2.85	2.90	2.95
20 yr gilt	2.65	2.75	2.85	2.95	3.00	3.05	3.10	3.15	3.20	3.25	3.30	3.30
50 yr gilt	2.70	2.80	2.90	3.00	3.05	3.10	3.15	3.20	3.25	3.30	3.55	3.60

Underlying assumptions:

- The UK economic recovery has continued. Household consumption remains a significant driver, but there are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP in 2015.
- We expect consumption growth to slow, given softening housing market activity, the muted outlook for wage growth and slower employment growth. The subdued global environment suggests there is little prospect of significant contribution from external demand.
- Inflationary pressure is currently low (annual CPI is currently 0.5%) and is likely to remain so in the short-term. Despite a correction in the appreciation of sterling against the US dollar, imported inflation remains limited. We expect commodity prices will remain subdued given the weak outlook for global growth.
- The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.
- Nominal earnings growth remains weak, despite large falls in unemployment, which poses a dilemma for the MPC. Our view is that spare capacity remains extensive. The levels of part-time, self-employment and underemployment are significant and

indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.

- However, we also expect employment growth to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure.
- In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone. These factors will maintain the dovish stance of the MPC in the medium term.
- The continuing repair of public and private sector balance sheets leave them sensitive to higher interest rates. The MPC clearly believes the appropriate level for Bank Rate for the post-crisis UK economy is significantly lower than the previous norm. We would suggest this is between 2.5 and 3.5%.
- While the ECB is likely to introduce outright QE, fears for the Eurozone are likely to maintain a safe haven bid for UK government debt, keeping gilt yields artificially low in the short term.
- The probability of potential upside risks crystallising have waned a little over the past two months. The primary upside risk is a swifter recovery in the Eurozone.
- We continue to forecast the first rise in official interest rates in Q3 2015; general market sentiment is now close to this forecast. There is momentum in the economy, but inflationary pressure is benign and external risks have increased, reducing the likelihood of immediate monetary tightening.
- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited; we believe the normalised level of Bank Rate post-crisis to range between 2.5% and 3.5%.
- Market sentiment (derived from forward curves) has shifted significantly lower in the past three months; market expectations are now for a later increase in interest rates and a more muted increase in gilt yields.
- The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. We project gilt yields on an upward path in the medium term.

ANNEX 4

Counterparty Policy

The investment instruments identified for use in 2015-16 are listed below under the 'Specified' and 'Non – Specified' investment categories. Specified investments are considered low risk and relate to funds invested for up to one year. Non-specified investments normally offer the prospect of higher returns but carry higher risk and may have a maturity beyond one year. All investments are sterling denominated.

As discussed in sections 4 & 5 above the plan during 2015-16 is to reply on short term debt and minimise cash balances. This will lead to short duration DMO and money market denominated cash portfolio to cover liquidity needs.

Specified Investments

Instrument	**Country/ Domicile**	**Counterparty**	**Maximum Counterparty Limits £m**	**Maximum period of investment**
Term Deposits	UK	Debt Management Account Deposit Facility (DMADF), Debt Management Office (DMO)	No limit	364 days
Gilts	UK	Debt Management Office (DMO)	No limit	364 days
Treasury Bills	UK	Debt Management Office (DMO)	No limit	364 days
Term Deposits/ Call Accounts	UK	Other UK Local Authorities	£30m per local authority	364 days
Term Deposits/ Call Accounts/ Certificates of Deposit/covered deposits	UK or AAA	Counterparties rated at least AA- Long Term (or equivalent)	£20m per bank or banking group	364 days
Constant Net Asset Value Money Market Funds (MMFs)	UK/Ireland/Luxembourg domiciled	AAA rated Money Market Funds	£20m per MMF*; Group limit £100m	Instant Access

Investments do not include capital expenditure as defined under section 25(1) (d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate). Investment in gilts would only be undertaken on advice from the Council's treasury management adviser.

For credit rated counterparties, the minimum criteria will be the lowest equivalent long-term ratings assigned by Fitch, Moody's and Standard & Poor's (where assigned).

Long-term minimum: A- (Fitch); A3 (Moody's); A- (S&P)

The Council will also take into account the range of information on investment counterparties detailed in section 5.9.

The limits stated will apply across the total portfolio operated by the Council and so incorporate both Council and Pension Fund specific investments.

The limits for the period of investment are the maximum for the categories of counterparties. Lower operational limits will apply if recommended following a review of creditworthiness.

* Limit per MMF to be no more than 2.0% of the Money Market Fund's total assets.

The use of non-UK banks has previously been suspended. Six countries retain AAA ratings from all three rating agencies – Australia, Canada, Germany, Singapore, Sweden and Switzerland. Within these countries ten banks meet the AA- or better criteria mentioned above. Only three of these are active in the UK deposits market and these have been included as eligible counterparties (annex 5). Using the highest quality overseas banks will both improve the overall security of the investment portfolio and enable greater diversification.

Non- Specified Investments

Instrument	**Country/ Domicile**	**Counterparty**	**Maximum Counterparty Limits £m**	**Maximum period of investment**
Gilts	UK	Debt Management Office (DMO)	£10 million	36 Months
Term Deposits/ Call Accounts	UK	Other UK Local Authorities	£30m per local authority	36 Months
Term Deposits/ Call Accounts/ Certificates of Deposit/covered deposits	UK	Counterparties rated at least A- Long Term (or equivalent).	£20m per bank or banking group	364 days
Variable NAV Enhanced Cash Funds	UK/Ireland/Luxembourg domiciled	AAA - rated Funds	£5m per ECF*; Group limit £15m	Minimum Weekly Redemption

Non specified investments generally have either longer maturities than one year or weaker credit ratings than AA-, but not both. Maturities in excess of

12 months will only be used after discussion with the Corporate Committee but have been included to remove the need for mid year strategy amendments.

Enhanced Cash Funds

Last year enhanced cash funds (also known as short dated bond funds) were included in the counterparty policy for the first time. To date, no investment has been made in these funds, which share many of the characteristics of money market funds. ECF's target a higher return than money market funds by extending the average maturity.

The use of such funds has been discussed with the Council's treasury advisor who are supportive provided the exposure is limited to 20-25% of the total deposits and we invest with higher security / lower volatility funds. A maximum of £5 million invested with a single fund is proposed. The Corporate Committee will be notified before the first investment with any such fund. The ECF's and money market funds used will only invest in cash and bonds, not equities or property due to the latter's greater volatility.

ANNEX 5

Lending List of counterparties for investments

This is the proposed list of counterparties which the Council can lend to, providing the counterparties meet the requirements set out in Annex 4 at the time of investment. The list will be kept under constant review and counterparties removed if the process described in 5.7 and 5.8 raises any concerns about their credit worthiness.

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit £m	Arlingclose Suggested max maturity
Gilts, Treasury Bills, Term Deposits	UK	Debt Management Office (Term deposits & Deposit Facility)	No limit	N/A
Term Deposits	UK	Other Local Authorities	£30m per local authority	N/A
Term Deposits/ Call Accounts/ Certificates of Deposit	UK	Barclays Bank Plc	20	100 days
Term Deposits/ Call Accounts/ CDs	UK	HSBC Bank Plc	20	6 months
Term Deposits/ Call Accounts/ CDs	UK	Lloyds Banking Group including Lloyds TSB and Bank of Scotland	20	6 months
Term Deposits/ Call Accounts/ CDs	UK	Santander UK	20	6 months
Term Deposits/ Call Accounts/ CDs	UK	Nationwide Building Society	20	6 months
Term Deposits/ Call Accounts/ CDs	UK	Standard Chartered Bank	20	6 months
Term Deposits/ Call Accounts/ Certificates of Deposit	UK	Coventry Building Society	20	100 days
Term Deposits/ Call Accounts/ CDs	Sweden	Svenska Handelsbanken	20	6 months
Term Deposits/ Call Accounts/ CDs	Australia	National Australian Bank	20	6 months
Term Deposits/ Call Accounts/ CDs	Australia	Australia & New Zealand Banking Group	20	6 months

Compared with last year, RBS has been removed from list and Santander UK, Coventry Building Society and the three non UK banks added. Arlingclose recommend maximum maturities of 6 months for the above with the exception

of Barclays and Coventry Building Society (100 days). Coventry is one of the best capitalised banks or building societies in the UK and once the credit ratings of UK banks are adjusted to reflect reduced government support, its credit ratings will also be among the highest.

The counterparty list excludes MMF and ECF's as the name of the fund reflects the fund manager not the quality of the underlying holdings. Selection of MMFs and ECFs will be based on the criteria set of in Annex 4. The limit for any single MMF is £20 million and each ECF is £5 million.