Appendix B

TREASURY MANAGEMENT STRATEGY 2014/15 – 2016/17

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

Current Portfolio Position

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

£	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
External Debt					
Debt at 1 April	2,100,000	2,100,000	2,100,000	2,100,000	2,100,000
Expected change in debt	0	0	0	0	0
Debt at 31 March	2,100,000	2,100,000	2,100,000	2,100,000	2,100,000
CFR	1,838,000	1,838,000	1,838,000	1,796,000	1,754,000
Under/(over) borrowing	(262,000)	(262,000)	(262,000)	(304,000)	(346,000)
Investments					
Total Investments at 31 March	*1,000,000	2,500,000	2,500,000	2,500,000	2,500,000
Net Debt	1,100,000	(400,000)	(400,000)	(400,000)	(400,000)

*In addition to this £1,646,325 was also held in cash and bank balances

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	**2013/14** **£**	**2014/15** **£**	**2015/16** **£**	**2016/17** **£**
Borrowing	3,000,000	3,000,000	3,000,000	3,000,000
Other long term liabilities	-	-	-	-
Total	**3,000,000**	**3,000,000**	**3,000,000**	**3,000,000**

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

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

The Council is asked to approve the following Authorised Limit:

Authorised limit	**2013/14** **Estimate**	**2014/15** **Estimate**	**2015/16** **Estimate**	**2016/17** **Estimate**
Borrowing	6,000,000	6,000,000	6,000,000	6,000,000
Other long term liabilities	-	-	-	-
Total	6,000,000	6,000,000	6,000,000	6,000,000

Prospects for Interest Rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Capita asset Services central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations. Growth prospects remain strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction.

The current economic outlook and structue of market interest rates and government debt yields have several key treasury management implications:

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of government debt to GDP ratios, in some countries, continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2014/15 and beyond;

- Borrowing interest rates have risen significantly during 2013 and are on a rising trend.

Borrowing Strategy
This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations.

The Head of Finance, under delegated powers, will monitor interest rates in the financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp **fall** in long and short term rates, e.g. due to a marked increase in risk around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered
- If it was felt that there was a significant risk of a much sharper **rise** in long and short term rates than currently forecast, perhaps arising from a greater than expected world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

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

Given the Council's capital financing requirements over the coming years, there is little likelihood of the Council increasing its external debt.

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

- Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure – This is similar to the previous indicator and covers a maximum limit on fixed interest rates.
- Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

	2014/15	2015/16	2016/17
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	50%	50%	50%
Limits on fixed interest rates: Debt only	3,000,000	3,000,000	3,000,000
Limits on variable interest rates: Debt only	750,000	750,000	750,000

Maturity Structure of fixed interest rate borrowing 2014/15		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	30%
5 years to 10 years	0%	50%
10 years and above	0%	100%

These are limits that apply to the total portfolio for in house investments

Policy on Borrowing in advance of need

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

Borrowing in advance will be made within the constraints that:

- The Council would not look to borrow more than 18 months in advance of need.

Risks associated with any advance borrowing activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

If the Council had to borrow temporarily for cash flow purposes only in an emergency, then the Head of Finance, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking in to account the risks. A report will subsequently be reported to Council. In all other circumstances, approval to borrow money will always be a decision that can only be made by Full Council and a full report will be brought to Members.

Given the Council's capital financing requirements over the coming years, there is little likelihood of the Council increasing its external debt.

Debt Rescheduling

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

The reasons for any rescheduling to take place will include:

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

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. In light of current interest rates and penalties incurred in repaying debt it is unlikely that debt rescheduling will be undertaken in the near future.

The Council has enquired as to whether there is any opportunity to reschedule the PWLB loan of £2.1 million but the associated early repayment charge and premium that would be charged makes this uneconomic at his stage.

All rescheduling will be reported to the Council, at the earliest meeting following its action.

ANNUAL INVESTMENT STRATEGY

Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using Capita Asset's ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets.

To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay this information on top of credit ratings. This is encapsulated within the credit methodology provided by the advisors, Capita Asset Services.

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

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in appendix C under the 'Specified' and 'Non-specified' investment categories. Counterparty limits will be set through the Council's Treasury Management Practices – Schedules.

Creditworthiness Policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour not to be used

The Capita Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of Short Term rating F1, Long Term rating A-, viability rating A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.

Country limits
The Council has determined that it will only use UK registered banks.

In-house Funds
Investments will be made with reference to the core balance and cash flow requirements and the outlook for the short-term interest rates.

Investment Returns Expectations
Bank rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.50%

- 2015/16 0.50%
- 2016/17 1.25%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

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

- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.00%
- 2017/18 2.00%

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

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

Maximum principal sums invested > 364 days			
£M	2014/15	2015/16	2016/17
Principal sums invested > 364 days	Nil	Nil	Nil

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

Investment Risk Benchmarking
These benchmarks are simple guides (not limits) to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- **0.08% historic risk of default when compared to the whole portfolio.**

Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Liquid short term deposits of at least £250,000 available with a week's notice.
- Weighted Average Life benchmark is expected to be 6 months, with a maximum of 1 year.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – Returns above the average 3 month LIBID rate

And in addition that the security benchmark for each individual year is:

	1 year	**2 years**
Maximum	0.08%	0.01%

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

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

Treasury Management Advisers
The Council uses Sector as its external treasury management advisors.

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

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

Scheme of delegation
Please see appendix D

Role of section 151 officer
Please see appendix D