Report to:	**Council**
Date:	**5 December 2017**
Title:	**2017/18 Treasury Management Strategy**
Portfolio Area:	**Resources and Performance – Cllr C Edmonds**
Wards Affected:	**All**

Relevant Scrutiny Committee:

Urgent Decision:	**N**	Approval and clearance obtained:	**Y**

Date next steps can be taken: Immediately

Authors:	Lisa Buckle	Role:	**Strategic Finance Lead (S151 Officer)**

Contact: **Email Lisa.buckle@swdevon.gov.uk 01803 861413**

Recommendations:

That the Council approves the following:

1. The prudential indicators and limits for 2017/18 to 2019/20 contained within Appendix A of the report.
2. The Minimum Revenue Provision (MRP) statement contained within Appendix A which sets out the Council's policy on MRP
3. The revised Treasury Management Strategy for 2017/18 and the treasury prudential indicators 2017/18 to 2019/20 contained within Appendix B.
4. The Investment Strategy 2017/18 Appendix C and the detailed criteria included in Appendix D.

1. Executive summary

This report seeks approval of a revised Treasury Management and Investment Strategies together with their associated prudential indicators. Good financial management and administration underpins the entire strategy.

Also on this Council agenda is a recommendation for a Commercial Property Acquisition Strategy Amendment, which would enable the Council to borrow up to £37.45 million (for a £35 million portfolio).

The Treasury Management Strategy for 2017/18 has been revised to include the proposals within the Commercial Property Acquisition Strategy Amendment and the Council's Borrowing Limits have been increased to £37.45 million for this aspect.

If the Commercial Property Acquisition Strategy is approved by Council on 5th December, the Council will also need to approve this revised Treasury Management Strategy for 2017/18.

The budget for investment income for 2017/18 has been set at £70,321. This is £25,000 higher than for 2016/17, due to predicted income from the investment in CCLA in 2017/18 (see below).

At Council in February 2017, it was approved (Minute CM54 and HC50) that a sum of £500,000 be used to invest in CCLA's (CCLA Investment Management Limited) Local Authorities Property Fund, with the investment being placed in 2017/18.

There is also a recommendation on the Council agenda to borrow a further £2.55 million to fund a Residential Property Purchase (Minute HC53 refers). This borrowing would not take place until 2019/20 at the earliest.

2. Background

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

The second main function of the treasury management service is the funding of the Council's capital plans.

These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

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

2.1 Reporting requirements

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

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

- The capital plans (including prudential indicators);
- A minimum revenue provision (MRP) policy
- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- An investment strategy (the parameters on how investments are to be managed).

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

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

Scrutiny - The above reports are required to be adequately scrutinised before being recommended to the Council. The three reports above are presented to the Audit Committee at the relevant times in the calendar year.

2.2 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

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

Treasury management issues
- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- The investment strategy;
- Creditworthiness policy; and
- Policy on use of external service providers.

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

2.3 Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. Treasury management training will be organised for Members during the 2017-18 financial year.

2.4 Treasury management advisors

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

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

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

3. Outcomes/outputs

The budget for investment income for 2017/18 has been set at £70,321. This is £25,000 higher than for 2016/17, due to predicted income from the investment in CCLA in 2017/18 (see Section 1).

4. Options available and consideration of risk

In order to maximise investment returns the Council needs to be able to either increase our investment portfolio which could potentially mean increasing the risk factor or maintain the current list of Counterparties but further increase the limit we can invest in each to avoid using those with the lowest rate of return.

5. Proposed Way Forward

If the Commercial Property Acquisition Strategy is approved by Council on 5th December and the Residential Property Purchase is approved, the Council will also need to approve this revised Treasury Management Strategy for 2017/18, to increase the Council's Borrowing limits respectively.

6. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	The elements set out in paragraph 2.2 cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code, the Department for Communities and Local Government (DCLG) Investment Guidance and the DCLG MRP Guidance.
Financial	Y	Good financial management and administration underpins the entire strategy. The budget for investment income for 2017/18 is £70,321. As at 31/3/17 (Balance Sheet position), the Council had £8,450,000 in investments. On 5th December 2017 the Council will consider an amended commercial property acquisition strategy. The recommendations are:-

		APPROVE & IMPLEMENT the amended commercial property acquisition strategy as detailed in Appendix A BORROW funds on fixed rate terms from the appropriate source in order to pursue this strategy. To complete tranche 1 this would require total borrowing of up to £37.45m (£35m plus acquisition costs of 7%) If the Commercial Property Acquisition Strategy is approved by Council on 5th December, the Council will also need to approve this revised Treasury Management Strategy for 2017/18. There is also a recommendation on the Council agenda to borrow a further £2.55 million to fund a Residential Property Purchase (Minute HC53 refers). This borrowing would not take place until 2019/20 at the earliest.
Risk	Y	The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation. The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines. The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Hub Committee as part of the budget reports.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	N/a

Safeguarding	N	N/a
Community Safety, Crime and Disorder	N	N/a
Health, Safety and Wellbeing	N	N/a
Other implications	N	none

Supporting Information
Appendices:

Appendix A - The Capital Prudential indicators 2017/18 to 2019/20.
Appendix B - The Treasury Management Strategy 2017/18
Appendix C – The Investment Strategy
Appendix D - Treasury Management Practice (TMP 1) – Credit and Counterparty Risk Management
Appendix E - Treasury Management Scheme of delegation
Appendix F - Glossary of Terms Appendix

Background Papers:
Audit Committee: 15/03/16 - TMS & Annual Investment Strategy 2016-17
Audit Committee: 27/09/16 - Annual TM Report 2015-16
Audit Committee: 10/01/17 - TMS (Mid Year Update)
Audit Committee: 21/03/17 -TMS and Annual Investment Strategy for 2017-18
Council: 11/04/2017 – TMS and Annual Investment Strategy

APPENDIX A

THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2019/20

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

Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Total	**300**	**651**	**41,970**	**901**	**3,151**

The capital expenditure estimates have been increased by £37.45 million in 2017/18 for the recommendations set out within the commercial property acquisition strategy. Similarly estimates for 2019/20 have been increased by £2.55 million for the Residential Property Purchase (HC 53).

This is explained in the Executive Summary of this report. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

The Capital Programme for 2017/18 will be financed as below:

Capital expenditure	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Total	**300**	**651**	**41,970**	**901**	**3,151**
Financed by:					
Capital receipts	32	0	0	0	0
Capital grants	244	239	402	402	402
Earmarked Revenue Reserves	24	0	80	0	0
New Homes Bonus	0	412	88	199	199
Net financing need for the year (This is the prudential borrowing required for the capital investment in leisure, the waste fleet, commercial property and residential property purchase)	**Nil**	**Nil**	**41,400**	**300**	**2,550**

The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). It is essentially a measure of the Council's underlying need to borrow.

In 2016/17 the Council has agreed to undertake prudential borrowing for the new leisure contract. The Council has also agreed borrowing for the waste fleet vehicles.

The Capital Financing Requirement has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. This is further explained within the Executive Summary of this report.

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual £000	**Actual £000**	**Estimate £000**	**Estimate £000**	**Estimate £000**
Capital Financing Requirement (CFR)					
Total CFR	1,757	1,715	43,073	42,610	44,375
Movement in CFR	-42	-42	41,358	-463	1,765
Net Financing need for the year	0	0	41,400	300	2,550
Less MRP and other financing movements	-42	-42	-42	-763	-785
Net borrowing requirement	-42	-42	41,358	-463	1,765

Minimum revenue provision (MRP) policy statement

Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2003 states that 'A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent'. The provision is made from revenue in respect of capital expenditure financed by borrowing or credit arrangements.

With all options MRP should normally commence in the financial year following the one in which expenditure was incurred. Regulation 28 does not define 'prudent'. However MRP guidance has been issued, which makes recommendations to authorities on the interpretation of that term. Authorities are legally obliged to 'have regard' to the guidance.

The first recommendation given by the guidance is to prepare, before the start of each financial year, an annual statement of the policy on making MRP in respect of that financial year and submit this to Full Council for approval.

The guidance aims to ensure that the provision for the repayment of borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.

The MRP policy to be adopted is as below:-

Borrowing	MRP Methodology
Commercial Property acquisition (Borrowing of up to £37.45 million) Residential Property Purchase	***Annuity Method (over the 50 years)*** Under this calculation, the revenue budget bears an equal annual charge (for principal and interest) over the life of the asset by taking into account the time value of money. Since MRP only relates to the 'principal' element, the amount of provision made annually gradually increases during the life of the asset. The interest rate used in annuity calculations will be referenced to prevailing average PWLB rates. Under this example, the MRP charge in Year 1 on a £37.45 million borrowing would be £367,000, this rises to £377,000 in Year 2 etc.
Waste Fleet, Leisure Investment and Kilworthy Park	**Asset Life Method** MRP is charged using the Asset Life method – based on the estimated life of the asset. This option provides for a reduction in the borrowing need over approximately the asset's life.

Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the receipt of net investment income against the net revenue stream. It is calculated by dividing investment income and interest received by the Council's Net Budget Requirement.

The financing costs have been increased to reflect the proposals within the commercial property acquisition strategy. These proposals have increased this indicator in 2018/19 and 2019/20.

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
Ratio of net financing cost to net revenue stream. This is a net cost.	1.1%	1.1%	3.4%	26.7%	27.9%

Estimates of the incremental impact of capital investment decisions on council tax

This indicator calculates the notional cost of the impact of lost investment income on the Council Tax, from spending capital resources.

The estimates of the impact on council tax (this is a notional indicator) have been revised for the proposals set out in the commercial property acquisition strategy.

The commercial property acquisition strategy has the potential to contribute to the forecast budget gap by £520,000 as set out in the report. If the borrowing for the Waste Fleet and for Leisure are excluded, the expected benefit from the commercial property acquisition strategy would equate to a benefit of (£3.70) in 2017/18, rising to (£25.80) in 2018/19 and (£23.17) in 2019/20.

These figures are the incremental impact of capital investments decisions on a Band D council tax (surplus). These figures are included within the 'future incremental impact of capital investment decisions on the Band D Council Tax' shown below.

The cost shown in 2017/18 of £1.96 and in 2019/20 of £0.36 are due to the fact that the financing costs and MRP costs of the waste fleet, leisure investment and residential property purchase are also included.

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£
Future incremental impact of capital investment decisions on the band D Council tax (Notional cost/(surplus))	0.01	0.06	1.96	(2.61)	0.36

APPENDIX B

TREASURY MANAGEMENT STRATEGY (BORROWING)

Introduction

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

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
External Debt					
Debt at 1 April	2,100	2,100	2,100	43,500	46,350
Expected change in debt					
Debt at 31 March	2,100	2,100	43,073	42,610	44,375
CFR	1,757	1,715	43,073	42,610	44,375
Under/(over) borrowing	-343	-385	-	-	-
Investments					
Total Investments at 31 March	7,875	8,450	8,000	8,000	8,000
Net (Investment)/Debt	-5,775	-6,350	35,073	34,610	36,375

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Capital Financing Requirement has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. This is further explained within the Executive Summary of this report.

The S151 Officer 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	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
Borrowing	3,000,000	3,000,000	45,000,000	47,500,000
Other long term liabilities	-	-	-	-
Total	**3,000,000**	**3,000,000**	**45,000,000**	**47,500,000**

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 Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. 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.

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

The figures in 2017/18 have increased to reflect the proposed borrowing for the new leisure contract and potential additional borrowing for the waste fleet.

The Operational Boundary has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. This is further explained within the Executive Summary of this report. Similarly the limits in 2019/20 have been increased by £2.55 million for the residential property purchase (HC 53).

2. ***The Council is asked to approve the following Authorised Limit:***

Authorised limit	**2015/16 Estimate £**	**2016/17 Estimate £**	**2017/18 Estimate £**	**2018/19 Estimate £**
Borrowing	6,000,000	6,000,000	48,000,000	50,500,000
Other long term liabilities	-	-	-	-
Total	**6,000,000**	**6,000,000**	**48,000,000**	**50,500,000**

The figures in 2017/18 have increased to reflect the proposed borrowing for the new leisure contract and potential additional borrowing for the waste fleet.

The Authorised Limit has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. This is further explained within the Executive Summary of this report. Similarly the limits in 2019/20 have been increased by £2.55 million for the residential property purchase (HC 53).

Prospects for interest rates

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.10
10 yr PWLB	2.10	2.10	2.20	2.30	2.40	2.40	2.50	2.60	2.60	2.70	2.70
25 yr PWLB	2.70	2.80	2.90	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.40
50 yr PWLB	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10	3.20

The predicted interest rate forecast from our treasury management advisors, Capita, is that interest rates will remain at 0.5% up to September 2018 and then in December 2018 the base rate is predicted to rise to 0.75%. By December 2019 the bank base rate is predicted to increase to 1%.

Borrowing Strategy
In July 2016 (Minute CM28) the Council agreed to undertake prudential borrowing for the new leisure contract. There is predicted to be £1.2 million of Leisure investment in 2017/18 (this is shown in the movement in CFR). The remaining leisure investment occurs in 18/19.

Also at Council on 26 July 2016 (Minute CM27), Council agreed that the Council enters into an external Waste Management arrangement; for a 2 year period and that the Council proceeds to acquire the fleet required to satisfy the West Devon Waste specification as set out in Appendix D of the July 2016 agenda report. If the cost of the fleet is to be financed through prudential borrowing.

There is also a report on this agenda for a commercial property acquisition strategy. There is a recommendation as part of that report to borrow funding of £37.45 million. The Revised Treasury Management Strategy reflects the increase in borrowing of £37.45 million.

Treasury management limits on activity
There are two 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 fixed interest rate exposure – This covers a maximum limit on fixed interest rates.
- Upper limits on variable interest rate exposure – This covers a maximum limit for variable interest rates.

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

Interest rate Exposures		**2017/18**	**2018/19**	**2019/20**
		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		45,000,000	45,000,000	45,000,000
Limits on variable interest rates: Debt only		3,500,000	3,500,000	3,500,000
Maturity Structure of fixed interest rate borrowing 2017/18				
			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 needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

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 S151 Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into 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.

Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed rates, opportunities to generate savings by switching from long term debt to short term debt are regularly evaluated. 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 this stage. All rescheduling will be reported to the Council, at the earliest meeting following its action.

APPENDIX C

The Investment Strategy

Investment policy

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

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

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

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

Investment instruments identified for use in the financial year are listed in appendix D under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as 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 utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. 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 suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years *
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- 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

** Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt –see appendix D.*

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it 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 F1 and a Long Term rating of A-. 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 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 daily basis via its Passport website, provided exclusively to it by Capita Asset Services. 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 any external support for banks to help support its decision making process.

Country and sector limits

The Council has determined that it will only use UK registered banks and Building Societies.

Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

The predicted interest rate forecast from our treasury management advisors, Capita, is that interest rates will remain at 0.5% up to September 2018 and then in December 2018 the base rate is predicted to rise to 0.75%. By December 2019 the bank base rate is predicted to increase to 1%.

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

Maximum principal sums invested > 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 364 days	£2 million	£2 million	£2 million

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.

APPENDIX D

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
5. A body that is considered of a high credit quality (such as a bank or building society)

Non-specified investments: These are any investments which do not meet the Specified Investment criteria.

CCLA Property Fund investment will be the Council's only Non-Specified Investment and there is a limit of £0.5 million for this asset class.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**Max % of total investments / £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	100%	6 months
Money market funds	AAA	£3 million	Liquid
Enhanced Cash Funds	AAA	£6 million	T + 2
Local authorities	N/A	£3 million	5 years

	Minimum credit criteria / colour band	Max % of total investments / £ limit per institution	Max. maturity period
Property Investment Funds – CCLA	N/A	£500,000	No fixed maturity date but will generally be up to 7 years
Term deposits with banks and building societies	Yellow	£3 million (£4 million for Lloyds – the Council's Bank)	Up to 5 years
	Purple		Up to 2 years
	Blue		Up to 1 Year
	Orange		Up to 1 Year
	Red		Up to 6 months
	Green		Up to 100 days
	No Colour		Not for use
The Council is not recommending using the following investment vehicles and this is reflected by showing 0% against the limit per institution.			
UK Government gilts	AAA	0%	Yellow (5 years)
UK Government Treasury bills	AAA	0%	6 months
Bonds issued by multilateral development banks	AAA	0%	Yellow (5 years)
CDs or corporate bonds with banks and building societies	Yellow	0%	Up to 5 years
	Purple		Up to 2 years
	Blue		Up to 1 year

	Minimum credit criteria / colour band	**Max % of total investments / £ limit per institution**	**Max. maturity period**
	Orange		Up to 1 year
	Red		Up to 6 months
	Green		Up to 100 days
	No colour		Not for use

SPECIFIED INVESTMENTS:

All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable.

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	-	In-house
Term deposits – local authorities	-	In-house
Term deposits – banks and building societies	Green	In-house

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
UK part nationalised banks	Blue	In-house	£3 million	Up to 1 year

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	MMF Rating	In-house
2. Money Market Funds	MMF Rating	In-house
3. Enhanced Cash Funds	EMMF	In-house

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

A Guide to Money Market Funds	
Definition	A pool of cash managed by an independent fund management company. Frequently these are well known banks or investment houses.
Investment	Investors purchase units (shares) of the fund which are held on their behalf in a custody account.
Returns	Returns in line with either 7-day or 1-month LIBID are targeted by most funds.
Liquidity	The funds are very liquid. Shares can be purchased and sold on the same day if necessary and without penalty. Deals are subject to a cut-off time which varies from manager to manager but can be as late as 2pm.
Variety	Two types of classes exist – 1) Stable Net Asset Value (SNAV) – the most common variety. Prices are fixed and interest is credited to investors in the form of a dividend. 2) Accumulating Net Asset Value (ANAV) – interest is credited to the shares and the price rises to reflect the return achieved.
Accounting	Purchases of MMF shares do not score as capital expenditure. Sales do not score as capital receipts.
Legality	Local authorities are permitted to invest in sterling denominated funds with an AAA credit rating and domiciled in the EU.
Regulation	UK-based Funds are regulated by the Financial Services Authority. Those domiciled in other EU zones (the majority) are regulated via the Undertakings for Collective Investment in Transferable Securities (UCITS) Code. The Code lays down strict common standards of investment and management.

Portfolio holdings	Cash is invested in a selection of high quality, high liquidity securities including: time deposits, certificates of deposit, short-dated gilts, corporate bonds and notes, commercial paper etc.
Credit rating	Local authorities are empowered to place funds in investment schemes with a high credit rating. Money Market Funds fall into this category and are all rated by one or more of the three rating agencies. Credit Quality – measures the financial strength of the fund (not the manager) and the probability of it defaulting.
Risk management	The funds eligible for local authority investment score highly on credit quality and low volatility. All have an AAA rating which means that the chances of default are considered minimal. 1) Rating requirements – in order to maintain an AAA rating fund managers must adhere to requirements specified by the rating agencies. These include: • A maximum exposure to any one counterparty (concentration ratio) between 5% & 10% • A maximum weighted average maturity (WAM) for the entire fund – typically 60 days • A minimum level of overnight investments to ensure high liquidity • A lower limit on quality of investment counterparty 2) Ring fencing – monies received from share purchases are invested in financial instruments by the managing organisation. Deposits/security investments are held in custody by a non-related company that specialises in custody services. Counterparty exposure of the fund (and of the investor) is to the underlying securities and not to the management company.
Exposure limits	In view of the funds' low concentration ratios; quality of asset holdings; maximum WAM and ring-fencing arrangements, counterparty risk is spread widely. MMFs possess the same status as external fund managers operating cash/gilt funds for local authorities. They should have their own counterparty limit which can be considerably greater than that accorded to individual investment counterparties.

APPENDIX E

Treasury Management Scheme Of Delegation

Full Council:

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy
- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Receiving and reviewing regular monitoring reports and acting on the recommendations
- Approving the selection of external service providers and agreeing terms of appointment

The treasury management role of the Section 151 Officer:

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing management information reports
- Reviewing the performance of the treasury management function
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- Ensuring the adequacy of internal audit, and liaising with external audit
- Recommending the appointment of external service providers
- To ensure that members with responsibility for treasury management receive adequate training in treasury management.
- Te review the training needs of treasury mangement officers periodically

APPENDIX F

GLOSSARY OF TERMS

Basis Point
1/100th of 1%, i.e., 0.01%

Base Rate
Minimum lending rate of a bank or financial institution in the UK

Benchmark
A measure against which the investment policy or performance of a fund manager can be compared

Bill of Exchange
A financial instrument financing trade

Callable Deposit
A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre-agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen, the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower

Cash Fund Management
Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio

Certificate of Deposit (CD)
Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD

Commercial Paper
Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing

Corporate Bond
Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies

Counterparty
Another (or the other) party to an agreement or other market contract (e.g., lender/ borrower/writer of a swap, etc)

CPI
Consumer Price Index – calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time.

CDS
Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap

Derivative
A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g., an option is a derivative because its value changes in relation to the performance of an underlying stock.

DMADF
Deposit Account offered by the Debt Management office, guaranteed by the UK government

ECB
European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle

EMU
European Monetary Union

Equity
A share in a company with a limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain

Fed.
Federal Reserve Bank of America – sets the central rates in the USA

Floating Rate Notes
Bonds on which the rate of interest is established periodically with reference to short-term interest rates

Forward Deal
The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed date

Forward Deposits
Same as forward dealing (above)

Fiscal Policy
The Government policy on taxation and welfare payments

Gilt
Registered British Government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent

Gilt Funds
Pooled fund investing in bonds guaranteed by the UK government

Money Market Fund (MMF)
A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF

Monetary Policy Committee (MPC)
Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two year's time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment

Open Ended Investment Companies
A well diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread

Other Bond Funds
Pooled funds investing in a wide range of bonds

Reverse Gilt Repo
This is a transaction as seen from the point of view of the party which is buying the gifts. In this case, one party buys gifts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gifts on a specified future date, or at call, at a specified price

Retail Price Index (RPI)
Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person

Sovereign Issues (Ex UK Gilts)
Bonds issued or guaranteed by nation states, but excluding UK government bonds

Supranational Bonds
Bonds issued by supranational bodies, e.g., European investment bank. These bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts

Term Deposit
A deposit held in a financial institution for a fixed term at a fixed rate

Treasury Bill
Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value

WARoR
Weighted Average Rate of Return is the average annualised rate of return weighted by the principal amount in each rate

WAM
Weighted Average Time to Maturity is the average time, in days, till the portfolio matures, weighted by principal amount

WATT
Weighted Average Total Time is the average time, in days, that deposits are lent out for, weighted by principal amount