

# Treasury Management Strategy Statement

## Minimum Revenue Provision Policy Statement and Annual Investment Strategy

### 2015/16

## 1 *Introduction*

### **Background**

- 1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 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."

### **Reporting requirements**

- 1.4 The Council is required to receive and approve three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are all required to be reviewed by the Council's Scrutiny Panel.
- 1.5 **Prudential and Treasury Indicators and Treasury Strategy** (This report) – The first, and most important report is recommended to Full Council following consideration by the Scrutiny Panel. It covers:
  - the capital plans (including prudential indicators);
  - a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);
  - the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
  - an investment strategy (the parameters on how investments are to be managed).
- 1.6 **Mid Year Treasury Management Report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and

whether the treasury strategy is meeting requirements or whether any policies require revision.

- 1.7 **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.
- 1.8 Members will also be kept informed of any other significant matters that may occur as part of the quarterly Capital Monitoring reports to Scrutiny Panel.

**Training**

- 1.9 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management or scrutiny receive adequate training in treasury management. Training has previously been undertaken by members and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

**Treasury Management Strategy for 2015/16**

- 1.10 The strategy for 2015/16 covers the following Capital and Treasury Management issues:
- the capital plans and the prudential and treasury indicators;
  - the Minimum Revenue Provision (MRP) Policy;
  - the current treasury position;
  - the economic background and prospects for interest rates;
  - the borrowing strategy;
  - the investment policy and strategy; and
  - the policy on use of external service providers.
- 1.11 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.

**Treasury management consultants**

- 1.12 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.
- 1.13 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

**2 The Capital Prudential Indicators 2015/16 – 2017/18**

- 2.1 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

- 2.2 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 £'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Non-HRA	12,732	10,113	2,775	1,280	1,700
HRA	10,077	16,214	14,714	13,890	12,494
<b>Total</b>	<b>22,809</b>	<b>26,327</b>	<b>17,489</b>	<b>15,170</b>	<b>14,194</b>

- 2.3 The table below summarises how the above capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total Expenditure	<b>22,809</b>	<b>26,327</b>	<b>17,489</b>	<b>15,170</b>	<b>14,194</b>
<b>Financed by:</b>					
Capital receipts	6,836	7,240	1,966	0	1,700
Capital grants	5,046	3,001	760	1,280	0
Reserves	6,164	7,590	5,592	5,846	5,514
Revenue	2,693	7,936	4,806	4,515	4,757
Finance leases	1,057	149	0	0	0
<b>Net financing need</b>	<b>1,013</b>	<b>411</b>	<b>4,365</b>	<b>3,529</b>	<b>2,223</b>

### The Capital Financing Requirement

- 2.4 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 2.5 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.
- 2.6 The CFR includes any other long term liabilities (e.g. finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council had £3.3m of such schemes within the CFR as at 31 March 2014. The Council is asked to approve the CFR projections below:

£'000	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
<b>Capital Financing Requirement</b>					
CFR – non housing	27,653	26,009	24,890	23,830	22,824
CFR - housing	124,577	125,647	130,012	133,541	135,764
<b>Total CFR</b>	<b>152,230</b>	<b>151,656</b>	<b>154,902</b>	<b>157,371</b>	<b>158,588</b>
<b>Movement in CFR</b>	966	(574)	3,246	2,469	1,217

<b>Movement in CFR represented by</b>					
Net financing need	1,013	411	4,365	3,529	2,223
Assets acquired under finance leases	1,057	149	0	0	0
Less MRP	1,104	1,134	1,119	1,060	1,006
<b>Movement in CFR</b>	<b>966</b>	<b>(574)</b>	<b>3,246</b>	<b>2,469</b>	<b>1,217</b>

### **Minimum revenue provision (MRP) Policy Statement**

- 2.7 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP) if required.
- 2.8 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:
- 2.9 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will follow the existing practice outlined in former CLG regulations (option 1). This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- 2.10 From 1 April 2008 for all unsupported borrowing (including finance leases) the MRP policy will be the Asset Life Method (option 3) – MRP will be based on the estimated life of the assets, in accordance with the regulations. This provides for a reduction in the borrowing need over approximately the asset's life. Repayments included in finance leases are applied as MRP.
- 2.11 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.
- 2.12 The Accountancy team will keep the Council's MRP Policy under review to ensure that it remains fit for purpose in relation to its borrowing requirements.

### **Affordability Prudential Indicators**

- 2.13 The previous paragraphs 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:

- 2.14 **Ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

% Financing costs to net revenue stream	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
Non-HRA	7.48%	7.72%	7.50%	7.50%	7.60%
HRA	18.88%	18.57%	18.26%	18.20%	18.10%

- 2.15 The estimates of financing costs include current commitments and the proposals in this report.
- 2.16 **Incremental impact of capital investment decisions on council tax.** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

£	2015/16	2016/17	2017/18
	Estimate	Estimate	Estimate
Council Tax - Band D	0	0	0

- 2.17 **Incremental impact of capital investment decisions on housing rent levels.** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels. This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

£	2015/16	2016/17	2017/18
	Estimate	Estimate	Estimate
Weekly housing rents	0	0	0

### 3 **Treasury Management Strategy**

- 3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.
- 3.2 The Council's treasury portfolio position at 31 March 2014, with forward projections are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
<b>External Debt</b>					
Borrowing	136,094	139,292	145,905	151,180	154,677
Other long-term liabilities	2,787	2,248	1,746	1,274	760
<b>Gross debt at 31 March</b>	<b>138,881</b>	<b>141,540</b>	<b>147,651</b>	<b>152,454</b>	<b>155,437</b>
CFR	152,230	151,656	154,902	157,371	158,588
<b>Under / (over) borrowing</b>	<b>13,349</b>	<b>10,116</b>	<b>7,251</b>	<b>4,917</b>	<b>3,151</b>
Investments at 31 Mar	34,764	34,353	29,988	26,459	24,236
<b>Net Debt</b>	<b>104,117</b>	<b>107,187</b>	<b>117,663</b>	<b>125,995</b>	<b>131,201</b>

3.3 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 2015/16 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.

3.4 The Chief Finance 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 report.

#### **Treasury Indicators: Limits to Borrowing Activity**

3.5 The **Operational Boundary** is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	139,292	145,905	151,180	154,677
Other long term liabilities	2,248	1,746	1,274	760
<b>Total</b>	<b>141,540</b>	<b>147,651</b>	<b>152,454</b>	<b>155,437</b>

3.6 The **Authorised Limit** for external debt represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.7 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. The Council is asked to approve the following Authorised Limit:

Authorised limit £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	164,308	168,456	171,697	173,628
Other long term liabilities	2,248	1,746	1,274	760
<b>Total</b>	<b>166,556</b>	<b>170,202</b>	<b>172,971</b>	<b>174,388</b>

3.8 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA debt cap	140,275	140,275	140,275	140,275
HRA CFR	125,647	130,012	133,541	135,764
HRA headroom	14,628	10,263	6,734	4,511

HRA Debt Ratios £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA debt	125,647	130,012	133,541	135,764
HRA revenues	29,985	30,512	31,082	31,769
Ratio of debt to revenues	4	4	4	4
Number of HRA dwellings	6,099	6,064	6,059	6,034
Debt per dwelling	21	21	22	22

## 4 Economic Outlook

4.1 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.

**Appendix A** draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita Asset Services central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (incl. certainty rate adjustment)		
		5 year	25 year	50 year
Dec-14	0.50%	2.00%	3.30%	3.30%
Mar-15	0.50%	2.20%	3.40%	3.40%
Jun-15	0.50%	2.20%	3.50%	3.50%
Sep-15	0.50%	2.30%	3.70%	3.70%
Dec-15	0.75%	2.50%	3.80%	3.80%
Mar-16	0.75%	2.60%	4.00%	4.00%
Jun-16	1.00%	2.80%	4.20%	4.20%
Sep-16	1.00%	2.90%	4.30%	4.30%
Dec-16	1.25%	3.00%	4.40%	4.40%
Mar-17	1.25%	3.20%	4.50%	4.50%
Jun-17	1.50%	3.30%	4.60%	4.60%
Sep-17	1.75%	3.40%	4.70%	4.70%
Dec-17	1.75%	3.50%	4.70%	4.70%
Mar-18	2.00%	3.60%	4.80%	4.80%

4.2 UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing,

business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

- 4.3 The US, the biggest world economy, has generated growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid-2015.
- 4.4 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:
  - Greece: the general election on 25 January 2015 is likely to bring a political party to power which is anti EU and anti-austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti-austerity political parties throughout the EU is much more difficult to quantify;
  - As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could 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 2015/16 and beyond;
  - Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities

(especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

## 5 ***Borrowing Strategy***

5.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

5.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Chief Financial Officer will monitor interest rates in 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 of risks around relapse into recession or of risks of deflation), then long term borrowing 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 that currently forecast, perhaps arising from a greater than expected increase in 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.

5.3 Any decisions will be reported to the Scrutiny Panel at the next available opportunity.

### **Treasury Management Limits on Activity**

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure 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.

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

Interest rate Exposures (£'000)	2015/16	2016/17	2017/18
Upper limit on fixed interest rates based on net debt	117,700	126,000	131,200
Upper limit on variable interest rates based on net debt	58,800	63,000	65,600

Maturity Structure of fixed interest rate borrowing	Lower	Upper
Under 12 months	0%	10%
12 months to 2 years	0%	20%
2 years to 5 years	0%	20%
5 years to 10 years	0%	20%
10 years to 20 years	0%	40%
20 years to 30 years	0%	40%
30 years to 40 years	0%	40%
40 years to 50 years	0%	40%

### Policy on Borrowing in Advance of Need

- 5.6 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.

### Debt Rescheduling

- 5.7 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). The reasons for any rescheduling to take place will include:
- the generation of cash savings and / or discounted cash flow savings;
  - helping to fulfil the treasury strategy;
  - enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 5.8 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.

- 5.9 Any rescheduling will be reported to the Scrutiny Panel at the earliest meeting following its action.

**Municipal Bond Agency**

- 5.10 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Council will consider making use of this new source of borrowing as and when appropriate.

**6 Annual Investment Strategy**

**Changes to credit rating methodology**

- 6.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.
- 6.2 It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.
- 6.3 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.
- 6.4 Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.
- 6.5 As a result of these rating agency changes, the credit element of Capita Asset Services future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that has always been taken, but a change to the use of Fitch and Moody's ratings. Furthermore, CDS prices will continue to be utilised as an overlay to ratings in the new methodology.

**Investment Policy**

- 6.6 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.
- 6.7 In accordance with the above guidance, 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.
- 6.8 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.
- 6.9 As with previous practice, ratings will 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 that information on top of the credit ratings.
- 6.10 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.
- 6.11 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 in one counterparty or country. The intention of the strategy is to provide security of investment and minimisation of risk.
- 6.12 Investment instruments identified for use in the financial year are listed in **Appendix B**, which includes Counterparty, time and monetary limits. These will cover both 'Specified' and 'Non-Specified' Investments.
- 6.13 Specified Investments are sterling denominated 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. Non-Specified Investments are those that do not meet the

specified investment criteria. A limit of £20m will be applied to the use of Non-Specified investments (this will partially be driven by the long term investment limits).

### **Creditworthiness policy**

- 6.14 The 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.
- 6.15 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 that 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 (UK Government debt or equivalent)
  - Dark Pink                5 years Enhanced money market funds (1.25 credit score)
  - Light Pink                5 years Enhanced money market funds (1.5 credit score)
  - Purple                      2 years
  - Blue                        1 year (nationalised or semi nationalised UK Banks)
  - Orange                    1 year
  - Red                         6 months
  - Green                      100 days
  - No Colour                 not to be used
- 6.16 The 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.
- 6.17 Typically the minimum credit ratings criteria the Council will use is a Short Term rating (Fitch or equivalents) of F1, and a Long Term rating 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 topical market information, to support their use.
- 6.18 All credit ratings will be monitored on a monthly basis. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

- any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list.
- 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.
- a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 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.

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

### **Country limits**

6.20 The Council will only use approved counterparties from countries with a minimum sovereign credit rating of AAA, based on the lowest available rating. However this policy excludes UK counterparties. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix C**. This list will be amended by officers should ratings change in accordance with this policy.

### **Investment strategy**

6.21 The Council will manage all of its investments in-house. 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).

6.22 The Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015/ 2016 0.75%
- 2016/ 2017 1.25%
- 2017/ 2018 2.00%

6.23 There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk

6.24 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.

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

- 2015/16 0.60%
- 2016/17 1.25%
- 2017/18 1.75%
- 2018/19 2.25%
- 2019/20 2.75%
- 2020/21 3.00%
- 2021/22 3.25%
- 2022/23 3.25%
- Later years 3.50%

**Investment treasury indicator and limit**

6.26 The limit for the total principal funds invested for greater than 364 days is 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.

£'000	2015/16	2016/17	2017/18
Max. principal sums invested > 364 days	5,000	5,000	5,000

**End of year investment report**

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