REPORT TO: **POLICY AND RESOURCES COMMITTEE – 14 MARCH 2016**

REPORT ON: **TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2016/2017**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **90-2016**

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy Statement and Annual Investment Strategy for 2016-2017, the preparation of which is a requirement of the Council's Treasury Policy Statement and the CIPFA Code of Practice on Treasury Management.

2 RECOMMENDATION

The Committee are asked to:

1 note that in terms of the Treasury Policy Statement, the Executive Director of Corporate Services is obliged to present the annual Treasury Management Strategy at the start of each financial year.

2 approve the strategy proposed by the Executive Director of Corporate Services for 2016/2017 as set out in the attached document "Treasury Management Strategy 2016/2017".

3 FINANCIAL IMPLICATIONS

There are no direct financial implications arising from the recommendations in this report. However, decisions made within the Treasury Management function will affect the cost of the Council's long and short-term borrowing in 2016/2017 and future years. The 2016/2017 Revenue Budget has been set including a provision of £25.682m for Capital Financing Costs and this is based on an average Loans Fund Interest rate of 4.1%

4 BACKGROUND

The Council's Treasury Policy Statement (Meeting of the Policy and Resources Committee of 14 March 2016, Report No 89-2016 refers) requires that the Policy and Resources Committee will receive and consider the Treasury Management Strategy in advance of each new financial year.

5 TREASURY MANAGEMENT STRATEGY 2016/2017

The Council's Treasury Management Strategy for 2016/2017 is set out in detail in the attached document. The net new borrowing required in 2016/2017 is £43m. In light of this there is expected to be phased borrowing during the year. This will be based on cash flow and interest rate monitoring to determine the term and value of each loan taken.

In light of the continuing uncertainties in the finance market, lending transactions will be closely monitored to achieve maximum security of capital. This will involve using all available sources of information to assess the financial strength of any counterparties.

6 POLICY IMPLICATIONS

This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

The major issue is with Risk Management. This is considered in Appendix C of the statement.

7 CONSULTATION

The Chief Executive and the Head of Democratic and Legal Services have been consulted.

8 BACKGROUND PAPERS

None

MARJORY M STEWART
EXECUTIVE DIRECTOR OF CORPORATE SERVICES **7 MARCH 2016**

DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2016/2017

Corporate Services

TREASURY MANAGEMENT STRATEGY 2016/2017

1 INTRODUCTION

The Local Government in Scotland Act 2003 and supporting regulations require the Council to 'have regard to' the 'Prudential Code for Capital Finance in Local Authorities' published by the Chartered Institute of Public Finance and Accountancy (CIPFA) in 2011 and therefore to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. They also require the Council to have regard to the 'Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes' published by CIPFA in 2011 which require the Council to set out its treasury management strategy for borrowing and investment and how it will give priority to security and liquidity in managing its investments.

The suggested strategy for 2016/2017 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita Treasury Services.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- prudential and treasury indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

<u>Balanced Budget Requirement</u>
It is a statutory requirement under Section 93 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

<u>Treasury Limits for 2016/2017 to 2018/2019</u>
It is a statutory duty under part 7 of the Local Government in Scotland Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to allocate to capital expenditure.

The Council must have regard to the Prudential Code when setting its capital expenditure plans, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is affordable.

The capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The borrowing limits are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

2 CURRENT TREASURY PORTFOLIO POSITION

The Council's loan debt position at 31 January 2016 was as follows:

		£m	£m	%
Fixed Rate Funding	Public Works Loan Board	366.6		
	Market Loans	20.0	386.6	85.3
Variable Rate Funding	Market Loans	20.0		
	Temporary Loans	46.8	66.8	14.7
Total Loan Debt			453.4	100.0
Investments				
Short Term Lending			2.5	

3 PRUDENTIAL AND TREASURY INDICATORS 2015/2016 - 2017/2018

Prudential and Treasury Indicators (Appendix A to this report) are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the Finance Committee and the revised Code was adopted on 26 March 2012 by the Policy and Resources Committee.

4 PROSPECTS FOR INTEREST RATES

The Council has appointed Capita Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix B draws together a number of current forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita Asset Services central view.

Capita Asset Services Interest Rate forecast (12 February 2016)

Quarter Ending	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2016	0.50	1.70	3.20	3.00
Jun 2016	0.50	1.90	3.20	3.00
Sep 2016	0.50	2.00	3.30	3.10
Dec 2016	0.50	2.10	3.30	3.10
Mar 2017	0.75	2.20	3.50	3.30
Jun 2017	0.75	2.30	3.50	3.30

Sep 2017	1.00	2.40	3.60	3.40
Dec 2017	1.00	2.60	3.60	3.40
Mar 2018	1.25	2.70	3.70	3.50
Jun 2018	1.25	2.80	3.70	3.60
Sep 2018	1.50	2.90	3.70	3.60
Dec 2018	1.50	3.00	3.80	3.70
Mar 2019	1.75	3.00	3.80	3.70

Economic Review and Outlook

(UK) GDP growth rates of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2.2%. Quarter 1 2015 was weak at +0.4% (+2.9% y/y), although there was a slight increase in quarter 2 to +0.5% before weakening again to +0.4% (+2.1% y/y) in quarter 3 and then picking up to +0.5% (2.2%) in quarter 4.

The Bank of England's February Inflation Report included a forecast for growth to remain around 2.2% – 2.4% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q1 2017. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, perhaps as early as June, rather than in 2017; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

5 BORROWINGS STRATEGY

The net borrowing requirement for capital expenditure is shown in Appendix A. In 2016/2017 it is £43m. Cash flows and PWLB rates will be monitored to determine the appropriate time to borrow and term of the loans to be taken. Estimates of the likely rates for different terms are shown at Appendix B. Short-term rates are expected to be lower but this must be balanced against the risk of having to re-finance at an earlier date.

Comparison of gross and net debt positions at year end	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	£m	£m	£m	£m
Actual external debt (gross)	445.0	477.0	520.0	571.0	577.0
Cash Balances	(2.5)	(5.0)	(5.0)	(5.0)	(5.0)
Net Debt	442.5	472.0	515.0	566.0	572.0

- As at 31 January 2016 the Council had a difference between gross debt and net debt of £2.5m
- The general aim of this treasury management strategy is to maintain the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

- Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Executive Director of Corporate Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, reporting the outcome of any decisions to the Policy and Resources Committee.

6 POLICY ON BORROWING IN ADVANCE OF NEED

The Council will not borrow in excess of its Capital Financing Requirement with the prime intention to profit from the investment of the extra sums borrowed. In accordance with the revised Code, 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.

7 DEBT RESCHEDULING

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).

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.

All rescheduling will be reported to the Policy & Resources Committee at the earliest meeting following its action.

8 ANNUAL INVESTMENT STRATEGY

Investment Policy

The Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular, the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code") and the Audit Commission's report on Icelandic investments. The Council's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Permitted investment instruments identified for use in the financial year are listed in Appendix C. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Changes to Credit Rating Methodology

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. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies.

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.

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 they have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, they will continue to utilise CDS prices as an overlay to ratings in their new methodology.

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.

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. If credit ratings are impacted as a result of the above, the Treasury Management Strategy will be revised.

Creditworthiness policy

This Council uses the creditworthiness service provided by Capita Asset Services. This service has been progressively enhanced over recent years and now uses the approach as detailed above with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties and may also use the following as overlays: -

- Credit watches and credit outlooks from credit rating agencies
- Credit Default Swap 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 can then be combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council
to determine the duration of investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:-

- Purple 1 year
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Capita creditworthiness service use ratings from all three agencies, but by using a scoring system, it does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored weekly. The Council is alerted daily to changes to ratings of all three agencies through its use of the Capita 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 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 Councils 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 government support.

The maximum deposit will be in line with counterparty credit rating as follows
- F1+ £12m
- F1 £10m.
- UK Local Authorities £10m
- Debt Management Agency £10m

Please note additional frictional cash balances may be held in the Council's current account (Royal Bank of Scotland). As Royal Bank of Scotland’s credit rating has been downgraded to F2, we will not actively use them for investment purposes.

<u>Country limits</u>

The Council will only use UK regulated institutions.

<u>Investment strategy</u>

In-house funds*:* The Council’s in-house managed funds are mainly cash-flow derived and thus only available for limited periods. Investments will accordingly be made with reference to the cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Interest rate outlook: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate forecasts for financial year ends (March) are as follows: -

- 2016/2017 0.75%
- 2017/2018 1.25%
- 2018/2019 1.75%

There is downside risk to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk.

For 2016/2017 it is suggested that the Council should budget for an investment return of 0.50% on investments placed during the financial year.

For its cash flow generated balances, the Council will seek to utilise its business reserve and call accounts which are currently paying higher than market rates.

<u>Policy on longer term investments</u>

Until the new investment regulations took effect from 1 April 2010, investing by Scottish local authorities was limited to one year. This restriction has been removed from that date and this authority accordingly wishes to be able to make use of this power at times when such investing is both appropriate and attractive.

This may be exercised in 2016/17 for general treasury management purposes in line with Capital Finance Requirements within the Capital Plan with the exception of earmarked investments made at the Discretion of the Executive Director of Corporate Services (see para appendix C paragraph 3 “Controls on Treasury Risks”).

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 Management Activity report.

Policy on the use of external service providers

The Council uses Capita Asset Services as its external treasury management advisers.

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.

Scheme of delegation

Policy and Resources Committee

- 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.

Executive Director of Corporate Services

- Appendix D shows the responsibilities of the Executive Director of Corporate Services per S.10 of the Council's Financial Regulations.
- approving the division of responsibilities within the Financial Services & Investment Section.
- approving the selection of external service providers and agreeing terms of appointment.
- 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.

Internal Audit

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Policy on scrutiny, monitoring and change of investment policies and practices

The Internal Audit Section will review the Treasury Management Practices (TMP's) of the authority. These set out all the policies and procedures in place to implement the treasury management strategy and the principles set out in the treasury management policy statement. They are intended to minimise the risk to the capital sum of investments and for optimising the return on the funds consistent with those risks. These TMP's have been adopted as part of the approval of the Treasury Policy Statement.

Any changes in the TMP's will be sent to Internal Audit for approval prior to implementation and any material change will be reported to the Policy and Resources Committee.

The Treasury Policy Statement will be reviewed at least every 3 years (last reviewed 14 March 2016).

A copy of the TMP's may be obtained from the Head of Corporate Finance.

Permitted Investments – non treasury investments

Definition of non treasury investments

Regulation 9 adds to the normal definition of investments the following categories: -

a All share holding, unit holding and bond holding, including those in a local authority owned company, is an investment.
b Loans to a local authority company or other entity formed by a local authority to deliver services, are an investment.
c Loans made to third parties are investments.
d Investment property is an investment.

Any loan issued to a third party is treated as an investment. Such loans are neither capital nor revenue transactions, but are often made for service reasons and for which specific statutory provision exists. These loans will normally be made at prevailing market rates but may on occasion for service reasons be offered at an interest rate below the market rate. All loans to third parties are classified as investments for the purposes of the Consent. Where the loan is advanced at less than a market interest rate there is an associated loss of investment return which would otherwise have been earned on these monies. Annual Strategies and Reports will need to recognise all loans to third parties as investments.

Investment balances forecasts

Regulation 31 requires this authority to provide forecasts for the level of investments for the next three years, in line with the time frame of our capital investment programme.

The table in Appendix E shows that treasury investment balances have fallen over 2014/2015.

APPENDIX A

PRUDENTIAL CODE INDICATORS - TREASURY MANAGEMENT INDICATORS

Adoption of Revised CIPFA Treasury Management Code of Practice | Yes

Upper limit for variable and fixed rate exposure

	Net principal re variable rate borrowing / investments	Net principal re fixed rate borrowing / investments
2015/16	30%	100%
2016/17	30%	100%
2017/18	30%	100%
2018/19	30%	100%
2019/20	30%	100%
2020/21	30%	100%

Actual External Debt

	£'000
Actual borrowing as at 31/03/2015	445,164
Actual other long term liabilities as at 31/03/2015	76,214
Actual external debt as at 31/03/2015	**521,378**

Maturity structure of fixed rate borrowing 2014/15

Period	Lower %	Upper %
Under 12 months	0	10
12 months & within 24 months	0	15
24 months & within 5 years	0	25
5 years & within 10 years	0	25
10 years +	50	95
Upper limit for total principal sums invested for over 364 days	n/a	No sums will be invested longer than 364 days

External debt, excluding investments, with limit for borrowing and other long term liabilities separately identified

	Authorised Limit			Operational Boundary		
	Borrowing £000	Other £000	Total £000	Borrowing £000	Other £000	Total £000
2015/16	502,000	75,000	577,000	477,000	75,000	552,000
2016/17	545,000	73,000	618,000	520,000	73,000	593,000
2017/18	597,000	71,000	668,000	572,000	71,000	643,000
2018/19	602,000	69,000	671,000	577,000	69,000	646,000
2019/20	599,000	67,000	666,000	574,000	67,000	641,000
2020/21	602,000	65,000	667,000	577,000	65,000	642,000

PRUDENTIAL CODE INDICATORS - PRUDENTIAL INDICATORS

	Capital Expenditure			Ratio of financing costs to net revenue stream	
	Non-HRA £000	HRA £000	Total £000	Non-HRA %	HRA %
2015/16	100,062	16,213	116,275	7.6	41.8
2016/17	104,169	18,362	122,531	7.8	40.7
2017/18	115,547	14,090	129,637	8.3	40.1
2018/19	35,339	14,655	49,994	8.9	40.4
2019/20	28,420	13,965	42,385	8.4	40.4
2020/21	32,360	13,765	46,125	8.6	37.8

	Net Borrowing Requirement (NBR)			Capital Financing Requirement (CFR)			
	1 April £000	31 March £000	Movement £000	Non-HRA £000	HRA £000	Total £000	Movement £000
2015/16	443,598	473,000	29,402	330,000	177,000	507,000	31,000
2016/17	473,000	516,000	43,000	368,000	180,000	548,000	41,000
2017/18	516,000	567,000	51,000	418,000	181,000	599,000	51,000
2018/19	567,000	573,000	6,000	422,000	181,000	603,000	4,000
2019/20	573,000	570,000	(3,000)	419,000	180,000	599,000	(4,000)
2020/21	570,000	574,000	4,000	423,000	179,000	602,000	3,000

	NBR v CFR Difference	Incremental Impact of Capital Investment Decisions	
	Total £000	Increase in council tax (band D) per annum £ (Note 1)	Increase in average housing rent per week £
2015/16	34,000	0.24	0.01
2016/17	32,000	0.77	0.21
2017/18	32,000	8.32	0.07
2018/19	30,000	10.73	(0.04)
2019/20	29,000	10.42	(0.22)
2020/21	28,000	11.31	(0.11)

Note 1 - The above figures reflect the incremental impact of the capital investment decisions within this 5 Year Plan on the Council Tax, with all other items held constant. In reality the Council will manage its Capital Financing Cost budget in the same way as other revenue budget headings to avoid a detrimental impact on Council Tax Levels.

APPENDIX B

OUTLOOK FOR INTEREST RATES – FORECAST 2016-2019

The data below shows a variety of forecasts published by a number of institutions. These are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy).

Capita Asset Services Interest Rate View													
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%
3 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.90%	1.00%	1.10%	1.30%	1.30%	1.60%	1.80%	1.90%
6 Month LIBID	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.20%	1.40%	1.60%	1.70%	1.80%	2.00%	2.20%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.20%	1.30%	1.50%	1.70%	1.90%	2.00%	2.10%	2.30%	2.40%
5yr PWLB Rate	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%
10yr PWLB Rate	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.30%	3.40%	3.50%	3.60%
25yr PWLB Rate	3.20%	3.20%	3.30%	3.30%	3.50%	3.50%	3.60%	3.60%	3.70%	3.70%	3.70%	3.80%	3.80%
50yr PWLB Rate	3.00%	3.00%	3.10%	3.10%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.60%	3.70%	3.70%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%
Capital Economics	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%
Capital Economics	2.10%	2.20%	2.50%	2.55%	2.80%	2.80%	3.05%	3.05%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.85%	2.85%	3.10%	3.10%	3.30%	3.30%	3.45%	3.45%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.20%	3.20%	3.30%	3.30%	3.50%	3.50%	3.60%	3.60%	3.70%	3.70%	3.70%	3.80%	3.80%
Capital Economics	2.85%	2.85%	3.10%	3.10%	3.30%	3.30%	3.45%	3.45%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.00%	3.00%	3.10%	3.10%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.60%	3.70%	3.70%
Capital Economics	2.90%	2.90%	3.15%	3.15%	3.35%	3.35%	3.50%	3.50%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

APPENDIX C

PERMITTED INVESTMENTS

This Council approves the following forms of investment instrument for use as permitted investments as set out in Table 1.

Treasury risks

All the investment instruments in Table 1 are subject to the following risks: -

1. **Credit and counterparty risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument.

3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

4. **Interest rate risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report.

5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Controls on treasury risks

1. **Credit and counterparty risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of high creditworthiness to enable investments to be made safely.

2. **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

3. **Market risk:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value. (The only exceptions are for Common Good, Insurance Fund assets where there is a slightly higher risk threshold). In specific circumstances the Executive Director of Corporate Services may earmark funds for longer term investment which may have a higher risk threshold and be subject to potential fluctuations in value. These risks are offset by the long term nature of the investment. The overall limit of such would be £10m.

4. Interest rate risk: this authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.

5. Legal and regulatory risk: this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited investments

Regulation 24 states that an investment can be shown in table 1 as being ‘unlimited’ in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category.

The authority has given no types of investment an unlimited category.

Objectives of each type of investment instrument

Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being ‘permitted’.

1. DEPOSITS

The following forms of ‘investments’ are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

a. **Debt Management Agency Deposit Facility.** (DMADF) This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest.

b. **Term deposits with high credit worthiness banks and building societies.** This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term) and now that measures have been put in place to avoid over reliance on credit ratings, the authority feels that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. The authority will ensure diversification of its portfolio of deposits ensuring that no more than £12m can be placed with any one institution or group.

c. **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills. This is likely to be the most widely used in 2014/2015.

2. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

a. **Government liquidity funds.** These are very similar to money market funds (see below) but only invest in government debt issuance with highly rated governments. They offer a lower rate of return than MMFs but slightly higher than the returns from the DMADF.

b. **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or risk appetite to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF. They also offer a constant Net Asset Value (NAV) i.e. the principal sum invested has high security.

c. **Gilt funds.** (Common Good and Insurance Fund only or at discretion of Executive Director of Corporate Services – see Appendix C paragraph 3 “Controls on Treasury Risks”) These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in AAA rated gilts. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.

d. **Bond funds.** (Common Good and Insurance Fund only or at discretion of Executive Director of Corporate Services – see Appendix C paragraph 3 “Controls on Treasury Risks”) These invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in bonds. They do have an exposure to movements in market prices of assets held so do not offer constant Net Asset Value.

e. **Equity funds** (Common Good and Insurance Fund only or at discretion of Executive Director of Corporate Services – see Appendix C paragraph 3 “Controls on Treasury Risks”) these invest in equities actively traded in the UK. They potentially offer a higher rate of return than both gilts and bonds. This therefore entails a higher level of risk exposure. They do have increased exposure to movements in market prices of assets held so do not offer constant Net Asset Value.

3. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills..

a. **Treasury bills.** These are short term bills (up to 12 months) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need or access to cash at any point in time. However, there is a spread between purchase and sales prices so early sales could incur a net cost during the period of ownership.

b. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

c. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government.** (refers solely to GEFCO - Guaranteed Export Finance Corporation). This is similar to a gilt due to the explicit Government guarantee.

4. OTHER

a. **Equities.** Direct investments in equities will only be held for service reasons. This therefore entails a higher level of risk exposure as they do not offer a constant Net Asset Value.

b. **Loans to Third Parties.** Loans issued to third parties are treated as investments. These loans are normally offered at prevailing market rates but may on occasion for service reasons be offered at an interest rate below the market rate. This will include Sub-ordinated Debt as part of Design, Build, Finance and Maintain projects.

Table 1: Permitted investments in house

1.1 Deposits

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max	Max. maturity period
Debt Management Agency Deposit Facility	-	term	no	£10m	per Capita Matrix
Term deposits - Local Authority	-	term	no	£10m	per Capita Matrix
Call accounts - banks and building societies	per Capita Matrix	instant	no	£12m	per Capita Matrix
Term deposits - banks and building societies	per Capita Matrix	term	no	£12m	per Capita Matrix
Fixed term deposits with variable rate and variable maturities:- Structured deposits.	per Capita Matrix	term	no	£12m	per Capita Matrix

1.2 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % of total or value	Max. maturity period
1. Government Liquidity Funds	Long-term volatility rating V1-V2	instant	no (see note A)	70%	60 days
2. Money Market Funds	Long-term volatility rating $AAA_{MM}f$	instant	no (see note A)	£10m	60 days
3. Gilt Funds (Common Good and Insurance Only or at discretion of Executive Director of Corporate Services – see Appendix C paragraph 3“Controls on Treasury Risks”)	Long-term volatility rating V1-V2	T+>1	yes	70% of asset class with any one institution	ongoing
4. Bond Funds (Common Good and Insurance Only or at discretion of Executive Director of Corporate Services – see Appendix C	Long-term volatility rating V1-V4	T+>1	yes	70% of asset class with any one institution	ongoing

paragraph 3 “Controls on Treasury Risks”)					
5. Equity Funds (Common Good and Insurance Only or at discretion of Executive Director of Corporate Services – see Appendix C paragraph 3 “Controls on Treasury Risks”)	*Long-term volatility rating V1-V7	T+>1	yes	70% of asset class with any one institution	ongoing

Note A: the objective of this fund to maintain the net asset value but they hold assets which can vary in value. However, the credit rating agencies require the fluctuation in unit values held by investors to vary by almost zero.

1.3 Securities issued or guaranteed by governments

	*Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	yes	20	1yr
UK Government	UK sovereign rating	Sale T+1	yes	20	1yr
Bond issuance by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	Sale T+3	yes	20	1yr

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.

1.4 Other

	*Minimum Credit Criteria	Liquidity Risk	Market Risk	Max %/value of total investments	Max. maturity period
Loans to Third Parties or Authority owned companies	-	term	no	£30m (£10m max with any single party)	ongoing

Unlisted equities in companies may be purchased and held for service reasons. The limit of such investments would be £100,000.

APPENDIX D

TREASURY MANAGEMENT

The Executive Director of Corporate Services and her staff shall ensure that all the Council's borrowing and lending transactions and practices comply with the CIPFA Code of Practice on Treasury Management in the Public Services.

The Executive Director of Corporate Services shall prepare a Treasury Policy Statement which will be approved by the Policy and Resources Committee and reviewed at least every three years.

The Executive Director of Corporate Services shall prior to the commencement of each financial year submit a report to the Policy and Resources Committee on the Treasury Management Strategy for that year.

The Executive Director of Corporate Services shall submit a report to the Policy and Resources Committee twice yearly reviewing the Council's Treasury Management activities. One of these reports will be an annual report on the Treasury Management activities of the previous financial year.

APPENDIX E

INVESTMENT FORECASTS	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Probable Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Cash balances managed in house					
1 April	9,320	2,380	5,000	5,000	5,000
31 March	2,380	5,000	5,000	5,000	5,000
change in year	(6,940)	2,620	0	0	0
average daily cash balances	16,730	11,500	10,000	10,000	10,000
Cash balances managed by managers					
1 April	0	0	0	0	0
31 March	0	0	0	0	0
change in year	0	0	0	0	0
average daily cash balances	0	0	0	0	0
TOTAL CASH BALANCES					
1 April	9,320	2,380	5,000	5,000	5,000
31 March	2,380	5,000	5,000	5,000	5,000
change in year	(6,940)	2,620	0	0	0
average daily cash balances	16,730	11,500	10,000	10,000	10,000
Holdings of shares, bonds, units (including authority owned company)					
1 April	1,036	1,036	1,036	1,036	1,036
Purchases	0	0	0	0	0
Sales	0	0	0	0	0
capital gain/(loss)	0	0		0	0
31 March	1,036	1,036	1,036	1,036	1,036
Loans to local authority owned company or other entity to deliver services					
1 April	3,900	3,900	4,216	4,216	4,216
Advances	0	316	0	0	0
Repayments	0	0	0	0	0
31 March	3,900	4,216	4,216	4,216	4,216
Loans made to third parties					
1 April	6,789	8,439	8,622	15,069	19,449
Advances	2,770	1,400	7,700	5,700	1,000
Repayments	(1,120)	(1,217)	(1,253)	(1,320)	(1,162)
31 March	8,439	8,622	15,069	19,449	19,287
Investment properties					
1 April	16,908	15,226	15,226	15,226	15,226
Gains	0	0	0	0	0
Losses	(1,682)	0	0	0	0
31 March	15,226	15,226	15,226	15,226	15,226
TOTAL OF ALL INVESTMENTS					
1 April	37,953	30,981	34,100	40,547	44,927
31 March	30,981	34,100	40,547	44,927	44,765
change in year	(6,972)	3,119	6,447	4,380	(162)