ANNEX 'C'

TREASURY MANAGEMENT STRATEGY STATEMENT - MINIMUM REVENUE POSITION STRATEGY and ANNUAL INVESTMENT STRATEGY 2016/17

1.0 INTRODUCTION:

1.1 Background

1.1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first 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.

1.1.2 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.

1.1.3 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. "

1.2 Reporting Requirements

1.2.1 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. In addition quarterly review reports provide a regular update to cabinet.

Prudential and Treasury Indicators and Treasury Strategy (This report)

1.2.2 The first, and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision 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).

A Mid Year Treasury Management Report

1.2.3 This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision. In addition, this Council will receive quarterly update reports.

An Annual Treasury Report

1.2.4 This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

1.2.5 The above reports are required to be adequately scrutinised by Members before being recommended to the Council. This role is undertaken by Audit, Givernance and Standards Committee.

1.3 **Treasury Management Strategy for 2016/17**

1.3.1 The strategy for 2016/17 covers two main areas:

(a) Capital Issues

- the capital plans and the prudential indicators
- the Minimum Revenue Provision (MRP) policy

(b) Treasury Management Issues

- the current treasury position
- treasury indicators which will limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- credit worthiness policy
- policy on use of external service providers
- Member training

1.3.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the Communities, Local Government Minimum Revenue Provision Guidance and Communities, Local Government Investment guidance.

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19:

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 prudential indicators, which are designed to assist Members overview and confirm their understanding of the Capital Programme.

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	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	1,620,795	14,271,397	20,529,986	11,183,901	669,000

2.3 Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has no PFI schemes.

2.4 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. In 2016/17, borrowing may occur only to fund the loan the Council is proposing to make to Broadacres Housing Association.

Capital Expenditure £000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	1,620,795	14,271,397	20,529,986	11,183,901	669,000
Financed by:					
Capital receipts	378,034	1,916,659	2,005,791	160,543	9,714
Capital grants	477,391	219,941	435,000	100,000	100,000
Capital reserves	765,370	2,134,797	3,023,566	843,901	493,000
Revenue	0	0	65,629	79,457	66,286
Net financing need for the year	**0**	**10,000,000**	**15,000,000**	**10,000,000**	**0**

The Council's Borrowing Need (the Capital Financing Requirement)

2.5 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.

2.6 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 assets life.

2.7 For the past few years, the CFR has remained at zero as the Council has been debt free and has had no underlying borrowing requirement. In 2016/17, due to the loan to Broadacres Housing Association the CFR will increase by the total amount borrowed for that scheme only. The total amount that is likely to be loaned to Broadacres Housing Association at £25,000,000 ha been used in the estimate of the CFR as this is the prudent position. This also provides the Council with the flexibility to use borrowing for the total amount of the Broadacres Housing Association loan in 2016/17 and in future if it chooses to do so but still allows the use of surplus funds. At the time the loan is taken consideration will be given to the Treasury Management environment to ensure that the best option to fund the loan to Broadacres Housing Association is taken.

2.8 The CFR also includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase 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 currently has no such schemes within the CFR.

2.9 The Council is asked to approve the CFR projections below:-

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Financing Requirement					
CFR – non housing	0	10,000,000	25,000,000	35,000,000	35,000,000
CFR - housing	0	0	0	0	0
Total CFR	**0**	**10,000,000**	**25,000,000**	**35,000,000**	**35,000,000**

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Movement in CFR	**0**	**10,000,000**	**15,000,000**	**10,000,000**	**0**
Net financing need for the year (above)	0	10,000,000	15,000,000	10,000,000	0
Less MRP and other financing movements	0	0	0	0	0
Movement in CFR	**0**	**10,000,000**	**15,000,000**	**10,000,000**	**0**

Minimum Revenue provision (MRP) Policy Statement

2.10 It is a statutory requirement that the Council reports on the Minimum Revenue Position and explains this policy. The Minimum Revenue Provision Policy describes that the Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement) through a revenue charge known as the Minimum Revenue Provision – MRP. The Council is also allowed to undertake additional voluntary payments if required. This is known as the Voluntary Revenue Provision - VRP.

2.11 This Council in 2016/17 will have a Capital Financing Requirement in relation only to the potential borrowing that will occur as a result of the capital expenditure incurred for the loan to Broadacres Housing Association.

2.12 Communities of Local Government (CLG) Regulations have been issued which require the Full Council to approve a **Minimum Revenue Provision (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 Minimum Revenue Provision Statement*:*

2.13 For capital expenditure incurred before 1 April 2008, or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

2.14 From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be*:*

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

2.15 Repayments included in annual PFI or finance leases are applied as Minimum Revenue Provision (MRP), though this Council does not expect to have these repayments in 2016/17 or in the foreseeable future.

2.16 The Capital Financing Requirement for the loan to Broadacres Housing Association will be a maximum of £25,000,000 in 2016/17 and future years. In the agreement with Broadacres Housing Association, they will make bullet repayments to the Council at years 5, 10, 15, 20 and 25. The bullet repayments made throughout the life of the loan will be set aside by the Council when received to ensure that prudent provision is made for regular repayment. These regular bullet points will be earmarked and used as the Minimum Revenue Provision that the Council needs to make on a regular basis to reduce the Capital Financing Requirement. Therefore, if £25,000,000 is loaned to Broadacres in 2016/17, the first time the MRP charge will be made to the revenue account to reduce the level of CFR will be 2020/21 and at regular intervals thereafter.

Core funds and expected investment balances

2.17 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances. Working capital balances (Debtors and Creditors) shown in the table are estimated for year end; these may fluctuate during the year. In 2016/17, 2017/18 and 2018/19 it should be noted that if the Council does not borrow £25,000,000 to fund the Broadacres Housing Association loan and instead uses its own core fund resources, then the 'Expected Investments' balances in the table below would be lower.

Year End Resources £000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Fund balances / reserves	16,294,438	13,780,025	10,960,113	10,942,111	10,780,601
Capital receipts	4,714,562	2,324,532	1,071,741	1,321,198	1,334,984
Provisions	0	0	0	0	0
Other	3,101,000	-104,557	-31,854	-263,309	-115,585
Total core funds	**24,110,000**	**16,000,000**	**12,000,000**	**12,000,000**	**12,000,000**
Under/over borrowing	0	0	0	0	0
Expected investments	**24,110,000**	**16,000,000**	**12,000,000**	**12,000,000**	**12,000,000**

Affordability Prudential Indicators

2.18 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:

2.19 **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) against the net revenue stream.

%	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Ratio	0	0	0	0	0

2.20 The estimates of financing costs include current commitments and the proposals in this report. The table shows that there is no ratio between the capital cost and net revenue stream because the borrowing which will potentially be undertaken is for the loan to Broadacres Housing Association. Ultimately this will not be a cost to the Council as the agreement between the Council and Broadacres will cover the costs incurred.

2.21 **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 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.

2.22 **Incremental impact of capital investment decisions on the Band D Council Tax**

£	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Council tax - band D	£0.00	£0.00	£0.00	£0.00	£0.00

3.0 BORROWING:

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 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 approporiate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

3.2 Current Portfolio Position

3.2.1 The Council's treasury portfolio position at 31 March 2015 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. This Council currently is debt free in 2015/16. In 2016/17 borrowing my occur for only two schemes – the loan to Broadacres Housing Association and Hambleton Lesiure Centre Improvement Schemes – and this is reflected in the table below:

£m	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External Debt					
Debt at 1 April	0	0	10,000,000	25,000,000	35,000,000
Expected change in Debt	0	10,000,000	15,000,000	10,000,000	0
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual debt at 31 March	**0**	**10,000,000**	**25,000,000**	**35,000,000**	**35,000,000**
The Capital Financing Requirement	0	10,000,000	25,000,000	35,000,000	35,000,000
Under / (over) borrowing	**0**	**0**	**0**	**0**	**0**
Total investments at 31 March					
Investments	**24,110,000**	**16,000,000**	**12,000,000**	**12,000,000**	**12,000,000**
Investment change		(8,110,000)	(4,000,000)	0	0
Net Debt / (Net Investment)		(6,00,000)	13,000,000	23,000,000	23,000,000

3.2.2 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 2016/17 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.

3.2.3 The Executive Director & Deputy Chief Executive (Section 151 Officer) reports that the Council complied with this prudential indicator in the current year 2015/16 and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

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

3.3.1 **The Operational Boundary.** This 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. Prior to 2016/17, the Council was debt free and had no borrowing, however, to give the Council complete flexibility these limits are always set at the beginning of each financial year. In addition to these flexibility requirements, in 2016/17 the possibility of borrowing for the loan to Broadacres Housing Association is also included in the operational boundary.

Operational boundary	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	4,000,000	14,000,000	29,000,000	39,000,000
Other long term liabilities	600,000	600,000	600,000	600,000
Total	**4,600,000**	**14,600,000**	**29,600,000**	**39,600,000**

3.3.2 **The Authorised Limit for external debt.** A further key prudential indicator 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.

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 this power has never yet been exercised.
2. The Council is asked to approve the following Authorised Limit. This limit is set to give the Council complete flexibility and also to encompass the maximum amount of borrowing that could occur for the borrowing in connection with the loan to Broadacres Housing Association:

Authorised limit £000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	5,000,000	20,000,000	35,000,000	45,000,000
Other long term liabilities	1,000,000	1,000,000	1,000,000	1,000,000
Total	**6,000,000**	**21,000,000**	**36,000,000**	**46,000,000**

3.4 **Prospects for Interest Rates**

3.4.1 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. The following table gives Capita Asset Services central interest rate view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2016	0.50	2.40	3.70	3.60
Jun 2016	0.75	2.60	3.80	3.70
Sep 2016	0.75	2.70	3.90	3.80
Dec 2016	1.00	2.80	4.00	3.90
Mar 2017	1.00	2.80	4.10	4.00
Jun 2017	1.25	2.90	4.10	4.00
Sep 2017	1.50	3.00	4.20	4.10
Dec 2017	1.50	3.20	4.30	4.20
Mar 2018	1.75	3.30	4.30	4.20
Jun 2018	1.75	3.40	4.40	4.30
Sep 2018	2.00	3.50	4.40	4.30
Dec 2018	2.00	3.50	4.40	4.30
Mar 2019	2.00	3.60	4.50	4.40

3.4.2 UK. UK Gross Domestic Product growth rates in 2013 of 2.2% 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 the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that Consumer Price Index inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

3.4.3 The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of Consumer Price Index during late 2015 / early 2016 but a second, more recent round of falls in fuel prices will now delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% in the second half of 2016 and not get to near 2% until 2017, though the forecasts in the Report itself were for an even slower rate of increase. There is considerable uncertainty around how quickly pay and Consumer Price Index inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee will decide to make a start on increasing Bank Rate.

3.4.4 **USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.1% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 has prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own Monetary Policy Committee.

3.4.5 **EZ.** In the Eurozone, the European Central Bank fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected Eurozone countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. Gross Domestic Product growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, this lacklustre progress in 2015 together with the recent downbeat Chinese and emerging markets news, has prompted comments by the European Central Bank that it stands ready to strengthen this programme of QE by extending its time frame and / or increasing its size in order to get inflation up from the current level of around zero towards its target of 2% and to help boost the rate of growth in the Eurozone.

Greece. During July, Greece finally capitulated to European Union demands to implement a major programme of austerity and is now cooperating fully with European Union demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to Gross Domestic Product. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to European Union demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost power. A left wing / communist coalition has taken power in Portugal which is heading towards unravelling previous pro austerity reforms. This outcome could be replicated in Spain. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 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.

3.5 Borrowing Strategy

3.5.1 The Council in 2015/16 is debt free, however in 2016/17 two schemes may incur borrowing as a result of the associated capital expenditure. The maximum amount of borrowing that would be incurred is £25,900,000. Alternatively, the Council may choose to use some of its surplus funds to fund the loan to Broadacres Housing Association and if this occurred the Council would be maintaining an under-borrowed position. This means that the capital borrowing needed (the Capital Financing Requirement), will not be 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.

3.5.2 If the Council does undertake borrowing then interest rates will be viewed from 1 year to 50 years, in accordance with the interest rates available from the markets as well as the Governments Public Works Loans Board. For 2016/17 interest rates span between 5 years at 2.4%, 25 at 4.3% or 50 years at 4%. The interest rates trend is to increase across all years as the 2015/16 year progresses. Therefore, in the current volatile money market, the borrowing target rate for 2016/17 is set at 3.8%. External borrowing will be considered throughout the financial year when interest rates seem most favourable.

3.5.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Executive Director 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 borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an 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.

Any decisions will be reported to the appropriate to Cabinet at the next available opportunity.

Treasury Management Limits on Activity

3.5.3 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 in place to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

3.5.3 The Council is asked to approve the following treasury indicators and limits in the table below. These limits take into account the potential borrowing to fund the loan to Broadacres Housing Association and the Hambleton Leisure Centre improvement Scheme and also provide the flexibility for additional borrowing where there may be a rare occasion when overnight temporary borrowing needs to occur. It should be noted that at this stage options have been left open when borrowing will occur due to the current volatility in the market.

	2016/17	**2017/18**	**2018/19**
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest	106	110	113

	2016/17	2017/18	2018/19
Interest rate Exposures			
rates based on net debt			
Limits on variable interest rates based on net debt	-6	-10	-13
Limits on Fixed Interest Rates: • **Debt only** • **Investments Only**	 100% 90%	 100% 90%	 100% 90%
Limits on Variable Interest Rates			
• **Debt only**	10%	10%	10%
• **Investments Only**	50%	50%	50%
Maturity Structure of interest rate borrowing 2014/15			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	20%
40 years to 50 years		0%	20%

3.6 Policy on Borrowing in Advance of Need

3.6.1 In 2016/17 borrowing is likely to occur to fund the loan to Broadacres Housing Association but not for any other purpose as in 2015/16 and the previous year the Council has been debt free. It is not anticipated therefore that there will be a need to borrow in advance of need during 2016/17. If the Council does borrow in advance of need it 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.

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

3.7 Debt Rescheduling

3.7.1 The Council up to 2015/16 has no debt outstanding and therefore does not need to consider debt rescheduling as part of this Strategy.

3.8 Municipal Bond Agency

3.8.1 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to Local Authorities sometime in the future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority could therefore potentially make use of this new source of borrowing as and when appropriate to fund all or part of the borrowing required for the two previously mentioned schemes.

3.9 Annual Investment Strategy

3.9.1 **Investment Policy –**

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

3.9.10 In accordance with the above guidance from the Communities and Local Government 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.

3.9.11 The Council's Treasury Management Advisor – Capita Asset Services – advises the Council on creditworthiness methodology which uses creditcritaria from the three main rating agencies (Fitch, Moody's and Standard & Poor's). The main rating agencies, 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 The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

3.9.12 In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

3.9.13 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA for the UK. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

3.9.14 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

3.9.20 With regards to counterparty limts and the amount of surplus funds to be placed with any one counterparty or group of counterparties, specific advice has been taken from the Council's Treasury Management Advisors (Capital Asset Services) due to the difficulty in placing surplus funds in the current economic environment. Therefore the Counterparty limits are detailed as follows:

- **Individual Limits** – These limits will be set at 30% of total investments or £3.0m per counterparty whichever is the higher. There are three exceptions to this policy:

  (a) with counterparties that are backed by the Government – Royal Bank of Scotland, Natwest, Ulster Bank – (and therefore are more secure) there will be a 40% limit or £5m per counterparty whichever is the higher.

  (b) with the Council's own bank - Lloyds - and associated banks in the Lloyds group – Bank of Scotland – there will be a 40% limit or £5m per counterparty whichever is the higher

  (c) with the Debt Management Agency Deposit there will be an unlimited amount with this organisation due to its high level of security.

  It should be noted that it is expected during 2016/17, that the status of the current counterparties backed by the Government in (a) above may change. If this occurs a report will be brought to Cabinet at the earliest opportunity with the revised limits.

- **Group Limits** – this policy recognises that individual counterparties (banks/financial institutions etc), whilst being sound in themselves, may be part of a larger group. This brings with it added risks where parent institutions may be in difficulties. Therefore, due to the reduced surplus balances available for investment, the group limit will also be as stated for the individual limits as it is important to diversify the risk to a variety of counterparties.

3.10 Creditworthiness policy

3.10.1 This Council applies the creditworthiness service provided by Capita Asset Services – the Council's Treasury Management Advisors. 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.

3.10.2 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of Credit Default Swap (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 for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt
- 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

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

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

3.10.4 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 topical market information, to support their use.

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

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis 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.

3.10.6 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.

3.11 Country and sector Limits

3.11.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent), other than the UK where the Council has set no limit. The list of countries that qualify using this AAA credit criteria, as at the date of this report, are shown in Annex C2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

3.11.2 On 22 February 2013, the UK lost its AAA sovereign rating and is now rated AA+. However, following advice from Capita Asset Services, the Council's Treasury Management Advisors, the Council will still operate with UK counterparties.

3.11.3 The Council has determined that, other than the United Kingdom where no limit will applies, a maximum of 30% of total investments or £3.0m whichever is the lower will be invested in a single institution of a AAA sovereign rated country

3.11.4 In addition, this policy restricts the total of investments in foreign countries to 40% of the total investments.

3.12 **Investment Strategy**

3.12.1 **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).

3.12.2 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from Quarter 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

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

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

- 2016/17 0.60%
- 2017/18 1.25%
- 2018/19 1.75%
- 2019/20 2.25%
- 2020/21 2.50%
- 2021/22 3.00%
- 2022/23 3.00%
- Later years 3.00%

3.12.4 The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

3.12.5 **Invesment 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.

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

Maximum principal sums invested > 364 days			
£000	**2016/17**	**2017/18**	**2018/19**
Principal sums invested > 364 days	£1,000,000	£1,000,000	£1,000,000

3.12.7 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.

3.13 **Investment Risk Benchmarking –** The Council is a member of Capital Asset Services Treasury Management Benchmarking Club to assist in the measuring of Treasury Management performance which enables comparison with other Council's for risk and return. This will be reported to Members on a quarterly basis during the 2016/17 financial year.

3.14 **End of year investment report -** At the end of the 2016/17 financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.1 **Policy on the Use of External Service Providers** – the Council uses Capital Asset services as its external Treasury Management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It is also recognised 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.

4.2 **Member Training** – Members with responsibility for Treasury Management will be provided with training in Treasury management. This especially applies to Members responsible for scrutiny. This training can be carried out by Council Officers and / or Capita Asset Services - the Council's Treasury Management advisors. The training needs of Treasury Management officers are also periodically reviewed.

ANNEX C1

TREASURY MANAGEMENT PRACTICE – TMP1
CREDIT AND COUNTERPARTY RISK MANAGEMENT
- SPECIFIED AND NON-SPECIFIED INVESTMENTS AND LIMITS

1.0 SPECIFIED INVESTMENTS:

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

2.0 NON-SPECIFIED INVESTMENTS:

2.1 These are any investments which do not meet the Specified Investment criteria. A maximum of 80% will be held in aggregate in non-specified investment

3.0 INVESTMENT INSTRUMENTS:

3.1 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.

3.2 The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

A) – SPECIFIED

Institution / Counterparty	*Minimum 'High' Credit Criteria*	*Use*
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	Coded: Orange on Capital Asset Services' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house
UK Part nationalised banks	Coded: Blue on Capital Asset Services' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Mangers

Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Coded: Blue on Capital Asset Services' Matrix. Fitch's rating: Long-term AAA, Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Mangers
Collateralised deposit	Coded: Orange on Capital Asset Services' Matrix / UK Sovereign rating	In-house and Fund Mangers
Certificates of deposits issued by banks and building societies covered by UK Government guarantee	Coded: Orange on Capital Asset Services' Matrix / UK Sovereign rating	In-house and Fund Mangers
Certificates of deposits issued by banks and building societies	F Coded: Orange on Capital Asset Services' Matrix / Fitch's rating: UK sovereign rating or Short-term F1+, Long-term AA or equivalent rating from Standard& Poors and Moodys	In-house and Fund Mangers
UK Government Gilts	Coded: Orange on Capital Asset Services' Matrix / UK Sovereign rating	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	Coded: Orange on Capital Asset Services' Matrix / Long term AAA	In-house buy and hold and Fund Managers
Bonds issued by a financial institution which is guaranteed by the UK Government	Coded: Orange on Capital Asset Services' Matrix / UK Sovereign rating	In-house buy and hold and Fund Managers
Sovereign bond issues (other than the UK Government)	Coded: Orange on Capital Asset Services' Matrix / Sovereign rating	In-house buy and hold and Fund Managers
Treasury Bills	Coded: Orange on Capital Asset Services' Matrix / UK Sovereign rating	Fund Managers

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	Short-term F1, Long-term AAA	In-house and Fund Managers
2. Money Market Funds	Short-term F1, Long-term AAA	In-house and Fund Managers
3. Enhanced cash funds	Short-term F1, Long-term AAA	In-house and Fund Managers
4. Bond Funds	Long-term AAA	In-house and Fund Managers
5. Gilt Funds	Long-term AAA	In-house and Fund Managers
6. Property Funds	Long-term AAA	In-house and Fund Managers

NON-SPECIFIED INVESTMENTS*:*
A maximum of 100% can be held in aggregate in non-specified investment

1. Maturities of ANY period

Institution / Counterparty	**Minimum Credit Criteria**	**Use**	**Max % of total investment s**	**Max. maturity period**
Term deposits – banks and building societies	Coded: red (6mths) and green (3mths) on Capital Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	100%	3-6 Months
Fixed term deposits with variable rate and variable maturities: -Structured deposits	Coded: orange (1yr) red (6mths) and green (3mths) on Capital Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	40%	1 Year
Certificates of deposits issued by banks and building societies NOT covered by UK Government guarantee	Coded: orange (1yr) red (6mths) and green (3mths) on Capital Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house buy and hold and Fund Managers	30%	1 Year

Commercial paper issuance covered by a specific UK Government explicit guarantee	UK Sovereign rating	In-house and Fund Managers	30%	1 Year
Commercial paper other	Coded: orange (1yr) red (6mths) and green (3mths) on Capital Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	30%	1 Year
Corporate Bonds	Coded: orange (1yr) red (6mths) and green (3mths) on Capital Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Managers	30%	1 Year
Other debt issuance by UK banks covered by UK Government guarantee	UK Government explicit guarantee	In-house and Fund Managers	30%	1 Year
Floating Rate Notes: the use of these investments would constitute capital expenditure unless they are issued by a multi lateral development bank	Long-term AAA	Fund Managers	N/A – Capital Expenditure	N/A – Capital Expenditure
Property fund: the use of these investments would constitute capital expenditure	--	Fund Managers	N/A – Capital Expenditure	N/A – Capital Expenditure

2. Maturities in excess of 1 year

Institution / Counterparty	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	30%	> 1 year
Term deposits – banks and building societies	Coded: Purple (2yrs)) on Capital Asset Services' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house	30%	> 1 year
Certificates of deposits issued by banks and building societies covered by UK explicit Government guarantee	UK Sovereign	In house and Fund Managers	30%	> 1 year
Certificates of deposits issued by banks and building societies	Coded: Purple(2yrs) on Capital Asset Services' Matrix / Short-term F1+, Long-term AA-	In house and Fund Managers	30%	> 1 year
UK Government Gilts	UK Sovereign rating	In-house and Fund Managers	30%	> 1 year
Bonds issued by multilateral development banks	Long term AAA	In-house and Fund Managers	30%	> 1 year
Sovereign bond issues (i.e. other than the UK Government)	Long term AAA	In-house and Fund Managers	30%	> 1 year
Collective Investment Schemes structure as open Ended Investment Companies (OEICs)				
1. Enhanced Cash Money Market Funds (Credit score of 1.25)	Coded: Dark Pink (5yrs) on Capital Asset Services' Matrix Short-term F1, Long-term AAA Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Managers	30%	> 1 year

2. Enhanced Cash Money Market Funds (Credit score of 1.5)	Coded: Light Pink (5yrs) on Capital Asset Services' Matrix Short-term F1, Long-term AAA Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Managers	30%	> 1 year
3. Bond Funds	Long-term AAA	In-house and Fund Managers	30%	> 1 year
4. Gilt Funds	Long-term AAA	In-house and Fund Managers	30%	> 1 year

ANNEX C2

APPROVED COUNTRIES FOR INVESTMENT
Current List as at January 2015

Capita Asset Services has advised that Councils should only use approved counterparties from countries with a minimum sovereign credit rating determined by the Council. This Council has determined that it will only use those countries with the sovereign rating of AAA other than the UK where the Council has set no limit. This list will be monitored at least weekly (and for information purposes only, includes other sovereign ratings)

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Norway
- Netherlands
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium
- Saudi Arabia