Agenda item No. 9

Audit Committee – 5 January 2014

Treasury Management Strategy 2015/16

1. Summary of report

1.1. This report sets out the council's proposed Treasury Management Strategy 2015/16 onwards **(Appendix A).** It is included in the council's Corporate budget plan 2015/16.

2. Recommendations

Audit Committee are asked to:

2.1. Note and endorse the draft Treasury Management Strategy Statement. **(Appendix A).**

2.2. Note that any changes required as a result of budget consultation, interest rate outlook, the Autumn Statement or Local Government Finance Settlement will be made prior to the final submission to Council for approval of the Strategy.

2.3 Note that changes to the Minimum Revenue Provision Policy Statement contained in the Treasury Management Strategy will be applicable from 2014/15 onwards.

James T Walsh – Assistant Director, Finance
(Chief Finance Officer)
19th December 2014

3. Background information

3.1. Treasury Management is defined 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."

3.2. **Appendix A** is the proposed Treasury Management Strategy 2015/16 which forms part of the council budget setting process presented to Cabinet and Council.

3.3. Members consider the strategy each year as a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services; the updated version (revised 2011) which Cabinet formally adopted on 22 March 2010.

3.4. The proposed strategy for 2015/16 onwards supports the council's 2015/16 Corporate budget plan and in particular the financing of the capital programme. It is based upon the treasury officers' view on interest rates, supplemented with leading market forecasts provided by the council's treasury adviser, Capita Asset Services.

The Strategy covers:-

- The Capital and Prudential Indicators 2015/16 and 2017/2018
- Minimum Revenue Provision (MRP) Policy Statement
- Borrrowing
- Annual Investment Strategy

Particular attention is given to issues raised by Audit Committee members these being:-

- Timing and reporting of prudential indicators in particular Prudential Indicator 3 and Prudential Indicator 4 (see page 5 and page 7)
- Minimum Revenue Provision (see pages 9 to 11).
- Treasury management limits on activity – maturity structure (see page 16).

3.5. Borrowing and investment objectives have been updated to take into account the expected rise in interest rates from June 2015. There are no current plans to take on additional borrowing. This is reviewed continually and may change if economic circumstances change, for example if there are signs that interest rates are going to rise more steeply than currently predicted.

3.6 Following a review the council's Minimum Revenue Provision policy statement has been updated and if approved will be implemented from 2014/15. See **Appendix 2** of the Treasury Management Strategy statement.

4. Resource and Legal considerations

4.1 Financial

The Treasury Management Strategy is a key document for the operation, review and performance assessment of treasury management and is reviewed annually. It forms part of the council's financial framework and supports delivery of the medium term financial strategy.

4.2 Legal

The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original Treasury Management Code in 1992 and further revised Codes in 2002 and 2011.

5. Risk and performance management issues

5.1 Risk

Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. The Treasury Management Policies approved by Audit Committee on 10 November 2014 provide the framework of governance and control in which the strategy operates.

5.2 Performance

The treasury management function participates in a local and national benchmarking group which compares Walsall council's treasury management performance with those of other councils. Performance is regularly reviewed by the treasury management panel. The treasury management annual report has been distributed to all councillors and will be used for member training. Indicators used for regular monitoring are shown in **Appendix 1** of the Treasury Management Strategy Statement.

6. Equality implications

6.1 None directly relating to this report.

7. Consultation

7.1 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the Chief Finance Officer, Head of Finance and Treasury Financial Administration and Systems Manager.

8.0 Background papers

- Various financial working papers
- Annual review of treasury management policy statement – Audit 10.11.14
- Financial Plan 2015/16 to 2018/19 – Draft revenue budget and capital programme - Cabinet 29.10.14

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Appendix A

Draft

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

1. Contents

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2. INTRODUCTION

2.1 Background

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

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

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

2.2 Treasury Management Strategy for 2015/16

The strategy for 2015/16 covers two main areas:

Capital issues

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

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy;
- policy on use of external service proiders.

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

2.3 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. Annual Treasury Management Briefings are held and further training is arranged as when required.

2.4 Treasury management consultants

The Council uses Capita Asset Services as its external treasury management advisors. The Council recognises that the 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.

2.5 Treasury management Monitoring

Local and Prudential indicators are used to monitor Treasury Management activities these are produced monthly and reported at least quarterly to the Treasury Management panel. The indicators that are monitored during the year are detailed in **Appendix 1.**

3. THE CAPITAL PRUDENTIAL INDICATORS 2015/16 – 2017/18

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

3.1 Capital expenditure Prudential Indicator 1

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 which will be included in the final draft for Cabinet on 4 February 2015. The financing need below excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The current capital plans which this strategy supports is detailed over in Table 1.

Table 1 Current Capital Programme £m	**2013/14 Actual £m**	**2014/15 Estimated - Sept 14 £m**	**2015/16 Estimated £m**	**2016/17 Estimated £m**	**2017/18 Estimated £m**
Total capital expenditure	**39.865**	**59.052**	**46.980**	**26.723**	**18.511**
Resourced by:					
• Capital receipts	3.342	7.631	2.875	1.500	1.500
• Capital grants	24.521	28.050	21.902	17.758	11.401
• Capital Reserves	1.069	0.821			
• Revenue	1.935		0.960	0.300	0.290
• Borrowing	8.998	22.550	21.243	7.165	5.320
Total to be financed	**39.865**	**59.052**	**46.980**	**26.723**	**18.511**

3.2 Affordability prudential indicators

The prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream – Prudential Indicator 2

This indicator identifies the trend in the cost of capital Financing (borrowing and other long term obligation costs net of investment income) against the council's net revenue stream.

Table 2 Prudential Indicator 2	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio Not Including MRP Policy Update	9%	10%	11%	12%	12%
Ratio Including MRP Policy update	9%	8%	10%	10.5%	11%

The estimates of financing costs include current commitments and the proposals in this budget report. Table 2 shows the ratio not including and including the reprofiling of MRP costs, following the proposed MRP policy change see section 4.5. It shows that the proposed change is required to maintain this ratio around the level of 10% to 11%.

Incremental impact of capital investment decisions on council tax – Prudential Indicator 3

This indicator see Table 3 identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. This indicator will change during a year if council makes changes during the year affecting the borrowing required to support the capital programme,

Table 3: Prudential Indicator 3	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Council tax - band D	£11.48	£18.19	£32.12	£10.04	£8.16

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

Prudential indicator 4 is the Council's Capital Financing Requirement (CFR). The CFR is 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.

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.

The CFR 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 schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £8.29m of such schemes within the CFR.

The Council is asked to approve the CFR projections in Table 4 below which show that the council's borrowing need for the period 2015/16 to 2017/18 is estimated to be £2.469m. The council's borrowing strategy is discussed in section 3.4.

Table 4 Analysis of CFR £m	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Total CFR	313.883	325.077	321.878	316.352
Movement in CFR	12.892	11.194	Cr 3.199	Cr 5.526
Net financing need for the year (above)				
Less MRP/VRP and other financing movements	Cr 9.658	Cr 10.049	Cr 10.364	Cr 10.846
Additional Borrowing	22.550	21.243	7.165	5.320
Movement in CFR	12.892	11.194	Cr 3.199	Cr 5.526
	Total			**2.469**

4. MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). The proposed policy statement to be recommended to council in the Corporate Budget Plan 2015/16 to be implemented in 2014/15 is detailed in **Appendix 2.**

4.1 MRP policy objectives

- The council shall determine for each financial year an amount of revenue provision for the future repayment of debt that it considers to be prudent.
- To set aside funds at a rate such that future generations who benefit from the assets are contributing to the associated debt and also avoiding the situation of future generations paying for the debt on assets that are no longer useable.

4.2 MRP Policy Review

The council's Borrowing costs (MRP and Interest Costs) is currently 25**%** of council tax requirement and 13.5% of tax revenue (council tax requirement plus NNDR contribution). As the council enters a period of reducing income an aim is to manage and maintain this position.

CLG regulations require the full Council to approve **an MRP Statement** each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement (**see Appendix 1**) it includes two changes in methodology. The changes are:-

Firstly MRP relating to Pre 2008 debt and Supporting Borrowing post 2008 is changed from a 4% reducing balance methodology to a 2% straight line basis this means that paragraphs 1 and 3 of the current policy are changed from:-

1. For any capital expenditure carried out prior to 31 March 2008 the authority will be adopting the regulatory method. This is where the MRP will be 4% of the opening capital financing requirement (CFR) (which has been adjusted as per the 2003 regulations).

3. For any capital expenditure carried out after 1 April 2008 being financed by Government supported funding the authority will again be adopting the regulatory method. Where the authority considers the capital expenditure to have added significantly to the lifespan of the asset, we will set aside funds for repayment in line with the appropriate life span of the asset type.

To a single paragraph:

For any capital expenditure carried out prior to 31 March 2008 and supported borrowing capital expenditure the authority will be charging MRP at 2% of the balance at 31 March 2013 (which has been adjusted as per the 2003 regulations), fixed at the same cash value so that the whole debt is repaid after 50 years.

This change is considered more prudent for the following reasons. Firstly, a consequence is that the pre 2008 debt will be fully provided for by 2064, if the regulatory method was continued with, £20m/13% of the debt would still be outstanding in 2064. Also, as this MRP element will be provided for on straight line basis, stability for budget planning is increased and affordability more easily achieved.

The second change relates to MRP for Unsupported Borrowing

Recommendation change paragraph 2. from:-

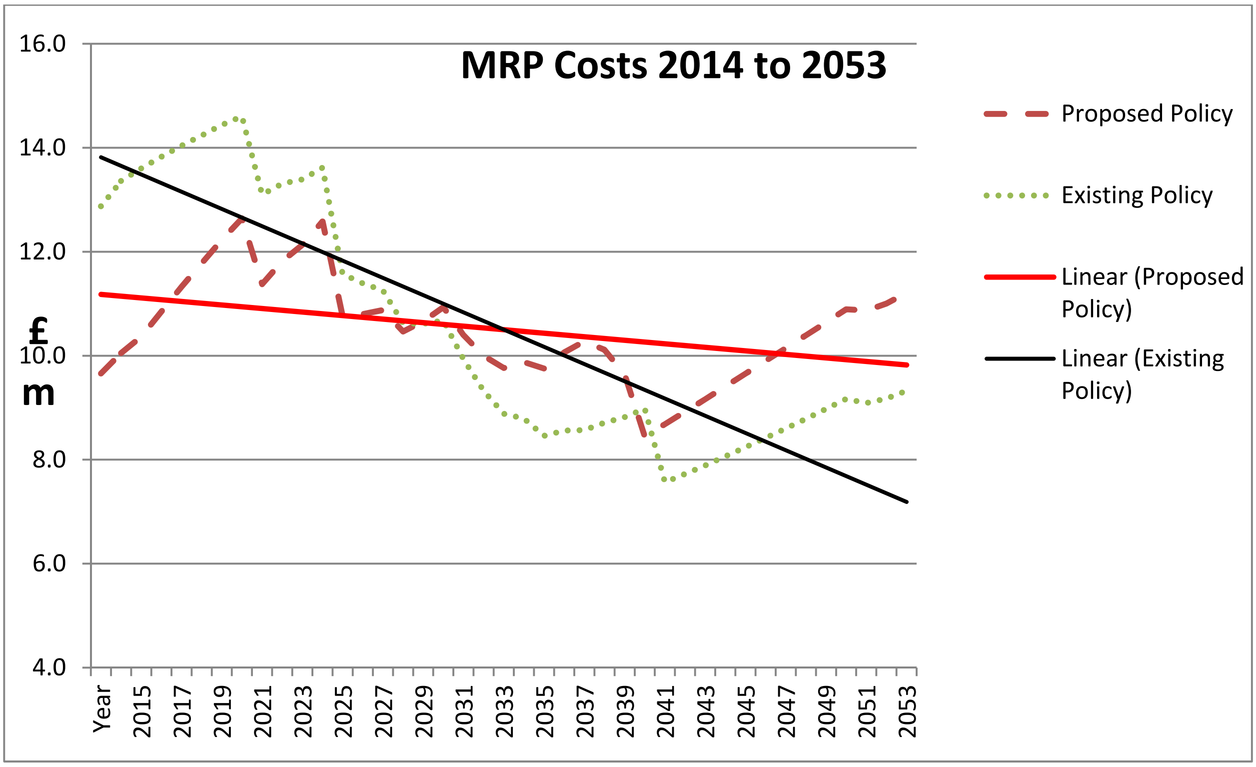
2. For any capital expenditure carried out after 1 April 2008 being financed by unsupported borrowing the authority will be adopting the asset life method (option 3). This is where MRP will be based on the capital expenditure divided by a determined asset life or profile of benefits to give annual instalments.

To a paragraph that makes explicit the options available to implement the asset life method.

2. For any capital expenditure carried out after 1 April 2008 being financed by unsupported borrowing the authority will be adopting the asset life method. This is where MRP will be based on the capital expenditure divided by a determined asset life or profile of benefits to give annual instalments. The annual instalment may be calculated by the equal instalment method, annuity method or other methods as justified by the circumstances of the case at the discretion of the Chief Finance Officer.

MRP guidance gives both the options of equal instalment asset life and annuity, having one option does not preclude the use of the other option. Both result in the payback being the same estimated term of the asset. When taking into account the time value of money the straight line method stacks the costs at the start of the project and the annuity profiles it more evenly. The annuity method is more appropriate for schemes where the benefits grow during the life of the project e.g. regeneration schemes. The other methods clause would arise in circumstances where the profile of benefits funding the repayment does not fit into the equal instalments or the annuity payback method. This could only be applied where it is consistent with the statutory duty to be prudent.

Graph 1 below projects the MRP costs from 2014 to 2053 it shows that the policy change proposed smoothes and re-profiles the MRP costs over the 40 year period. This model assumes that from 2020 to 2054 capital spend supported by borrowing is £5m per year. In both instances in 2053 the actual borrowing outstanding is £107m and the Capital Financing requirement is £103m. This demonstrates affordability and prudence as enough funds are being set aside to repay future borrowing. **Appendix 2** details the proposed Minimum Revenue Provision 2014/15 onwards



MRP Costs 2014 to 2053
16.0
14.0
12.0
10.0
8.0
6.0
4.0
£
m
Year
2015
2017
2019
2021
2023
2025
2027
2029
2031
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2035
2037
2039
2041
2043
2045
2047
2049
2051
2053
Proposed Policy
Existing Policy
Linear (Proposed Policy)
Linear (Existing Policy)

YEARS

5. BORROWING

The resourcing of capital expenditure plans set out in Section 3 provides details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the 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 appoporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

5.1 Current portfolio position

The council is expected to end 2015/16 with a borrowing portfolio of £245m against an asset base of approximately £500m, and short term investments of between £90m and £120m. These will be proactively managed to minimise borrowing costs and maximise investment returns within a robust risk management environment. In 2015/16 estimated annual interest payments are £10.5m and investment interest income is £0.916m. The net budget for capital financing in 2014/15 is £23.1m. The treasury management budget required for the running of the treasury management function for 2015/16 is £0.179m (2014/15 £0.185m). By having a proactive approach to managing cash flows and investments it is estimated that investment income of £0.181m above the bank base rate will be generated.

The council's treasury portfolio position at 30 November 2014 is shown in Table 5 below; forward projections are summarised below in Table 6. It shows the actual external borrowing (the treasury management operations), against the capital borrowing need, operational debt, and highlights any over or under borrowing. It shows that the council's underborrowing position is expected to continue for the medium term.

Table 5: Borrowing and Investments	**Borrowing £ m**	**Investments £ m**	**Net Borrowing £ m**
31-Mar-14	245.111	Cr 139.295	105.816
30-Nov-14	245.201	Cr 125.990	119.211
Change in year	0.090	13.305	13.395

Table 6 – Borrowing Forward Projections	**2015/16 £ m**	**2016/17 £ m**	**2017/187 £ m**
PWLB	106.588	106.621	96.655
Market Loans	122.000	122.000	122.000
Bonds and Temporary Loans	0.840	0.840	0.840
Net Other Local Authority Debt	15.063	14.251	13.356
Total Borrowing	244.491	243.712	232.851
Operational Debt – Prudential Indicator 6	316.787	313.588	308.062
(Under) / Over Borrowing	(72.296)	(69.876)	(75.211)

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. **Prudential Indicator 7** relates to the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer reports that the Council complied with **Prudential Indicator 7** in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

In accordance with **Prudential Indicator 8** the council has adopted and complies with the Cipfa code of Practice for Treasury Management.

5.2 Treasury Indicators: limits to borrowing activity

The authorised limit for external debt Prudential Indicator 5.

This 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 not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Table 7: Authorised limit £m Prudential Indicator 5	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Total	£m 349.022	£m 357.585	£m 354.066	£m 347.987

The operational boundary Prudential Indicator 6. This is the limit beyond which external debt is not normally expected to exceed. It has been calculated by deducting the other long term liabilities (£7.4m) from the Capital Financing Requirement (CFR).

Table 8: Operational Boundary £m Prudential Indicator 6	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Total	£m 307.527	£m 316.787	£m 313.588	£m 308.062

5.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Capita Assets' View on Interest rate prospects. If this is significantly changed before the report goes to council then the Treasury Management and Investment strategy will be updated.

Table 9: Prospects for Interest Rates				
Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 Year	25 Year	50 Year
Dec-14	0.5	2.5	3.9	3.9
Mar-15	0.5	2.7	4.0	4.0
Jun-15	0.75	2.7	4.1	4.1
Sep-15	0.75	2.8	4.3	4.3
Dec-15	1.0	2.9	4.4	4.4
Mar-16	1.0	3.0	4.5	4.5
Jun-16	1.25	3.1	4.6	4.6
Sep-16	1.25	3.2	4.7	4.7
Dec-16	1.5	3.3	4.7	4.7
Mar-17	1.5	3.4	4.8	4.8
Jun-17	1.75	3.5	4.8	4.8
Sep-17	2.0	3.5	4.9	4.9
Dec-17	2.25	3.5	4.9	4.9
Mar-18	2.5	3.5	5.0	5.0

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications see below. **Appendix 3** provides a detailed Economic commentary.

- The Eurozone, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and a triple dip recession since 2008. It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and possibly beyond;
- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when

authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

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

5.4 Borrowing Strategy

Our borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio
- To manage the council's debt maturity profile, ensuring no single future year has a disproportionate level of repayments
- To maintain a view on current and possible future interest rate movements and borrow accordingly
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and prudential indicators.

Specific Borrowing Objectives

- **L1**. Full compliance with the Prudential Code - **No Change.**
- **L2**. Average maturity date between 15 and 25 years **- No Change.**
- **L3 a**. Financing costs as % of council tax requirement **– Maintain current position through review of MRP policy and possible debt rescheduling. This indicator has been updated to include MRP costs.**
- **L3 b**. Financing costs as % of tax revenues (council tax requirement and NNDR contribution) **- Maintain current position through review of MRP policy and possible debt rescheduling. This indicator has been updated to include MRP costs.**
- **L4.** Actual debt as a proportion of operational debt range is maintained in the range 75%- 90% **- No Change**
- **L5.** Average interest rate for internally managed debt will be equal to or less than 4.6% - **No change**
- **L6.** Average interest rate for total debt (including other local authority debt) will be equal to or less than 4.73%.- **No change**
- **L7.** The gearing effect on capital financing estimates of 1% increase in interest rates increase must not be greater than 5% **- No change.**

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Treasury Manager 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 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 a greater than expected increase in the anticipated rate to US tapering of asset purchases, or 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.*

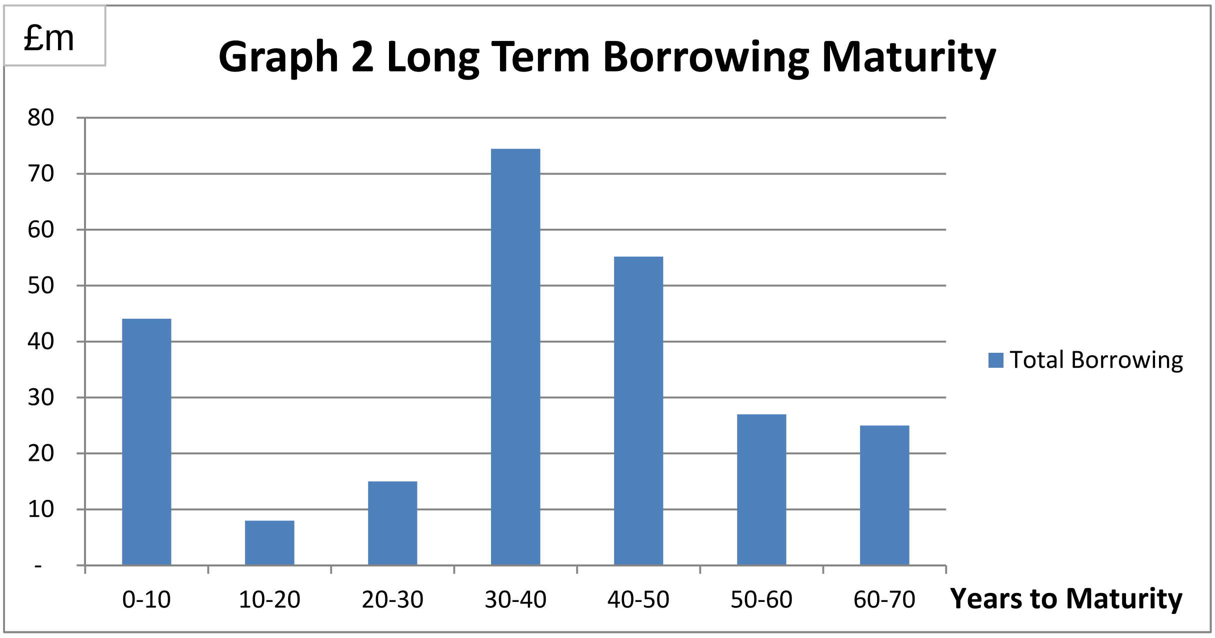
Any decisions will be reported to the appropriate decision making body at the next available opportunity.

5.5 Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these is 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. These limits have been reviewed. The indicators the council is asked to approved are:

Table 10a: Borrowing Limits	**2015/16**	**2016/17**	**2017/18**
Prudential Code Indicator 10 Upper limits on fixed interest rate exposures.	95%	95%	95%
Lower limits on fixed interest rate exposures	40%	40%	40%
Prudential Code Indicator 11 Upper limits on variable interest rate exposures	45%	45%	45%
Lower limits on variable interest rate exposures	0%	0%	0%
Table 10b: Borrowing Limits	**2015/16**	**2016/17**	**2017/18**
Prudential Code Indicator 12			
Lower limits for the maturity structure of borrowings:			
Under 12 Months	0%	0%	0%
12 months and within 24 months	0%	0%	0%
24 months and within 5 years	0%	0%	0%
5 years and within 10 years	5%	5%	5%
10 years and above	30%	30%	30%
Upper limits for the maturity structure of borrowings:			
Under 12 Months	25%	25%	25%
12 months and within 24 months	25%	25%	25%
24 months and within 5 years	40%	40%	40%
5 years and within 10 years	50%	50%	50%
10 years and above	85%	85%	85%

Graph 2 below shows the Maturity Structure of the council's borrowing portfolio.



Following a change in the Prudential Code guidance notes for the reporting of the maturity structure of LOBO loans; the maturity date is deemed to be the next call date. As £122m of the council's borrowing has a LOBO attached this measure has brought forward the reported maturity date. To reflect this change in presentation the lower limits for the maturity structure of borrowing have to be flexed each year to reflect the possible call date even though the council's borrowing has not changed. Table 11 below provides detail of the maturity loans and where applicable the next LOBO call date. Due to the low interest rate environment the probability of a LOBO borrowing being called is extremely low.

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

5.6 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 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 potential rescheduling would require the approval of the Treasury Management Panel.

6. ANNUAL INVESTMENT STRATEGY

6.1 Introduction: 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. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean that the council's creditworthiness policy will be under additional review and scrutiny in the coming months.

6.2 Investment policy

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

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

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.

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

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

6.3 Creditworthiness policy

Approved Organisations for Investments

Only organisations that are eligible to receive investments from local authorities may be used. The council's credit worthiness policy was reviewed and approved by Audit Committee on 10 November 2014 and council on 17th November 2014.

6.4 The Monitoring of Investment Counterparties

The credit rating and financial resilience of counter parties are monitored regularly. The council receives credit rating information from Capita Asset Services as and when ratings change and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list by the treasury manager, and if required new counterparties which meet the criteria will be added to the list.

6.5 Investment strategy

The general policy objective for this council is for the prudent investment of its treasury balances. The council's investment priorities are:

- The security of capital
- Liquidity of its investments
- All investments will be in sterling
- The council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

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

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 31st March 2016 1.00%
- 31st March 2017 1.50%
- 31st March 2018 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk. Capita Assets suggest budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

- 2015/16 0.90%
- 2016/17 1.50%
- 2017/18 2.00%

6.6 Specific Investment Objectives

- **L8**. Average interest rate received on STI Versus 7 day Libid rate – 0.5% - **No Change**
- **L9.** Average interest rate received on:
  - (a) At call investments – **0.4% - No Change**
  - (b) Short term investments – **0.9% - Changed from 0.8% to reflect market conditions.**
  - (c) Long term investments – **1.80% - Changed from 1.75% to reflect market conditions.**
- L10 Average rate on at call and short term investments will be equal to or greater than **0.8% - Changed from 0.7% due to market conditions**.
- L11. Average rate on all investments will be equal to or greater than 1.1**% - Changed from 0.9% due to market conditions**
- L12 % daily bank balances within a target range of 98% - **No Change**

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

The Council is asked to approve Prudential Indicator 9. treasury indicator and limit:

Prudential Indicator 9 Maximum principal sums invested > 364 days			
£m	**2015/16**	**2016/17**	**2017/18**
Principal sums invested > 364 days	£25m	£25m	£25m

7. APPENDICES

7.1 Appendix 1 - IN YEAR TREASURY MANAGEMENT INDICATORS TO BE MONITORED

No.	Indicator	2015/16	2016/17	2017/18
PCI 1	a. Capital expenditure - Council Resources	£25.078m	£8.965m	£7.110m
PCI 1	b. Capital expenditure - External Resources	£21.902m	£17.758m	£11.401m
PCI 2	Estimates of the ratio of financing costs to the net revenue stream	10.0%	10.5%	11.0%
L.3	a. Financing costs as % of council tax requirement	25.0%	25.0%	25.0%
L.3	b. Financing costs as % of tax revenues	13.5%	13.5%	13.5%
L.4	Actual debt versus operational debt within the following range	75%-90%	75%-90%	75%-90%
L.5	Average interest rate of debt excluding OLA less than	4.60%	4.60%	4.60%
L.6	Average interest rate of debt including OLA	4.73%	4.73%	4.73%
L.8	Average interest rate received on STI Versus 7 day LIBID rate	0.50%	0.50%	0.50%
L.9	Average interest rate received on:			
	(a) AT call investments	0.40%	0.75%	1.00%
	(b) Short Term investments	0.90%	1.50%	2.00%
	(c) Long Term investments	1.80%	2.20%	2.50%
L.10	Average interest rate on all ST investments. (ST and At call)	0.80%	1.30%	1.70%
L.11	Average rate on all investments	1.10%	1.50%	1.90%
L.12	% daily bank balances within target range	98%	98%	98%

7.2 Appendix 2 - MINIMUM REVENUE PROVISION 2014/15 ONWARDS

Under the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2010, local authorities have a duty to produce an annual statement on its policy for making a minimum revenue provision (MRP).
For the financial years 2014/15 onwards the authority will be adopting the following policies in determining the MRP:

1. For any capital expenditure carried out prior to 31 March 2008 and supported borrowing capital expenditure the authority will be charging MRP at 2% of the balance at 31 March 2013 (which has been adjusted as per the 2003 regulations), fixed at the same cash value so that the whole debt is repaid after 50 years.

2. For any capital expenditure carried out after 1 April 2008 being financed by unsupported borrowing the authority will be adopting the asset life method (option 3). This is where MRP will be based on the capital expenditure divided by a determined asset life or profile of benefits to give annual instalments. The annual instalment may be calculated by the equal instalment method, annuity method or other methods as justified by the circumstances of the case at the discretion of the Chief Finance Officer.

3. The authority will treat the asset life as commencing in the year in which the asset first becomes operationally available. Noting that in accordance with the regulations the authority may postpone the beginning of the associated MRP until the financial year following the one in which the asset becomes operational, there will be an annual adjustment for Assets Under Construction.

4. In all years the CFR for the purposes of the MRP calculation will be adjusted for other local authority transferred debt.

Finance Leases

In accordance with legislation the council will make a MRP for finance leases equivalent to the principal payment contained with the lease terms.

7.3 Appendix 3 - ECONOMIC BACKGROUND

This Economic Commentary is based upon information provided by our Treasury Management Advisors – Capita Asset Services. If you wish to read the full commentary please contact Michael Tomlinson ext 2360.

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 and especially during 2014, to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2015, particularly in the services and construction sectors. However, growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone. There does need to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this initial stage in the recovery to become more firmly established. One drag on the economy is that wage inflation has been lower than CPI inflation so eroding disposable income and living standards, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by warranting increases in pay rates. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen in the near future.The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1% and then to remain near to, or under, the 2% target level over the MPC's two year ahead time horizon. So markets are expecting that the MPC will be cautious in raising **Bank Rate** as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in **Government debt** by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018/19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

The Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to 0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. There are also particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 24% and unemployment among younger people of over 50 – 60%. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. Any loss of market confidence in the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA. The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions. It is currently expected that the Fed. will start increasing rates in mid 2015.

China. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporate in China. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds. The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Over time, an increase in investor confidence in world economic recovery is also likely to compound this effect as recovery will further encourage investors to switch from bonds to equities.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary. There is a significant danger that key financial ratios for them could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks currently include:

The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe. Fears generated by the potential impact of Ebola around the world

UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.

A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014. Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.

A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.

A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.

Recapitalisation of European banks requiring considerable government financial support.

Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.

Italy: the political situation has improved but it remains tenuous. Italy has the third highest government debt mountain in the world.

France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme..

Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan. Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.

There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

The potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include.

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

7.4 Appendix 4 - GLOSSARY OF TERMS

TERM	DEFINITION
Authorised Limit	Level of debt set by the council that must not be exceeded.
Bond	A government or public company's document undertaking to repay borrowed money usually with a fixed rate of interest.
Borrowing	Obtaining money for temporary use that has to be repaid.
Capital expenditure	Expenditure on major items e.g. land and buildings, which adds to and not merely maintains the value of existing fixed assets.
Capital grants	Specific targeted grants to cover capital expenditure.
Capital receipts	The proceeds from the disposal of land or other assets. Capital receipts can be used to fund new capital expenditure but cannot be used to finance revenue expenditure
Cash flow Management	The management of the authority's receipts and payments to ensure the authority can meet its financial obligations.
Counter party limits	Maximum amount that the council may lend to other institutions will vary according to size and credit rating of other intuitions.
Dividends	Sum to be payable as interest on loan.
ECB	European Central Bank
EU	European Union
EZ	Euro Zone
GDP	Gross Domestic Product – the total market value of all final goods and services produced in a country in a given year, equal to total consumer investment and government spending, plus the value of exports minus the value of imports.
IMP	International Monetary Fund – an organisation of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.
Investments	The employment of money with the aim of receiving a return.
Libid rate	London Interbank Bid Rate (the rate that banks are willing to borrow from each other)
LOBO	Lenders Option Borrowers Option. A type of loan arrangement.
Liquidity	How easily an asset including investments may be converted to cash.
Long Term Borrowing	Borrowing of money for a term greater than one year.
Long Term Liabilities	Amounts owed by the council greater than 12 months old.
Market convention	The rules and regulations by which all brokers and dealers should abide by. It includes standards of practice and calculation conventions for interest. They are defined in the London Code of Conduct ("The London Code") published by the Bank of England.

TERM	DEFINITION
MPC	Monetary Policy Committee – group that sets the bank base rate for the Bank of England
Temporary borrowing	Borrowing of money for a term of up to 364 days.
Treasury management	The management of the local authority's cash flows, its borrowings and its investments, the management of associated risks, and the pursuit of the optimum performance or return consistent with those risks.
Treasury Policy Statement	A statement of key policies that an organisation follows in pursuit of effective treasury management, including borrowing limits and strategy.
Variable debt	This is money that has been borrowed at a variable interest rate, and as such is subject to interest rate changes.
Unsupported borrowing	Borrowing taken through the remit of the Prudential Code for which the council will not receive any government funding and will fund from own resources.
Definition of Fitch Primary Credit Rating Scales	
Long Term Ratings A: High credit quality.	A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
Short-Term Ratings F1: Highest short term credit quality.	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
Definition of Moodys General Credit Rating	
LongTerm Corporate Obligation Ratings A	Obligations rated A are considered upper-medium grade and are subject to low credit risk.