# Dacorum Borough Council

# Treasury Management Strategy Statement

## Minimum Revenue Provision Policy Statement and Annual Investment Strategy

# 2016/17

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# 1 Introduction

## 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. A primary function of the Treasury Management service 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. The 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.

## 1.2 Clauses to be formally adopted

1. Dacorum will create and maintain the following for effective treasury management:
   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
   - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities

2. Full Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

3. Responsibility is delegated to the Section 151 Officer for the implementation and regular monitoring of its treasury management policies and practices, and for the execution and administration of treasury management decisions. They will act in accordance with the policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This organisation nominates Cabinet to be responsible for ensuring effective scrutiny of the treasury management strategy, policies and monitoring before recommendation to Full Council.

## 1.3 Treasury Management Policy Statement

Dacorum defines its treasury management activities as:

> *The management of the organisation's investments, cash flows, 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.*

Successful identification, monitoring and control of risk are the prime criteria by which the effectiveness of its treasury management activities will be measured. Analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Effective treasury management will provide support towards the achievement of Dacorum's business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

## 1.4 Reporting requirements

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

**Treasury Management Strategy Statement** (this report) - The first, and most important report, covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

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

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

## 1.5 Treasury Management Strategy for 2016/17

The strategy for 2016/17 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; and
- policy on use of external service providers.

## 1.6 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. The training needs of treasury management officers are periodically reviewed.

## 1.7 Treasury management consultants

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors.

The Council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. It also recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

# 2 The Capital Prudential Indicatiors 2016/17 – 2018/19

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.

## 2.1 Capital expenditure

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

| **Capital expenditure** | **2014/15 Actual £m** | **2015/16 Forecast £m** | **2016/17 Estimate £m** | **2017/18 Estimate £m** | **2018/19 Estimate £m** |
|---|---|---|---|---|---|
| Non-HRA | 16.335 | 22.071 | 21.820 | 15.331 | 1.909 |
| HRA | 25.468 | 32.036 | 28.182 | 29.368 | 25.649 |
| **Total** | **41.805** | **54.107** | **50.002** | **44.699** | **27.558** |
| **Financed by:** | | | | | |
| Capital grants & S106 | 3.469 | 5.031 | 0.757 | 2.166 | 0.366 |
| Capital receipts & reserves | 23.868 | 20.249 | 33.611 | 21.614 | 11.963 |
| Revenue | 14.468 | 18.885 | 5.796 | 15.549 | 9.517 |
| Borrowing | 0 | 9.942 | 9.838 | 5.370 | 5.712 |
| **Net financing need for the year** | **41.805** | **54.107** | **50.002** | **44.699** | **27.558** |

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total 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 is not immediately 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 Council is asked to approve the CFR projections below:

| £m | 2014/15 Actual £m | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| CFR – non housing | (0.011) | 9.942 | 19.780 | 21.256 | 21.256 |
| CFR – housing | 346.739 | 346.739 | 346.739 | 350.723 | 356.435 |
| **Total CFR** | 346.728 | 356.681 | 366.519 | 371.979 | 377.691 |
| **Movement in CFR** | | **9.953** | **9.838** | **5.460** | **5.712** |

| **Movement in CFR is represented by** | | | | | |
|---|---|---|---|---|---|
| Net financing need for the year | | 9.942 | 9.838 | 5.460 | 5.712 |
| Use of set aside capital receipts | | 0.011 | 0.000 | 0.000 | 0.000 |
| **Movement in CFR** | | **9.953** | **9.838** | **5.460** | **5.712** |

### 2.3 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), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

The MRP policy will be*:*

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations; or

These options provide for a reduction in the borrowing need over approximately the asset's life, the appropriate method would be selected upon borrowing or commencement of a project.

There is no requirement on the HRA to make a minimum revenue provision.

### 2.4 Core funds and expected investment balances

The use of funds to either finance capital expenditure or 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 and anticipated day to day cash flow balances.

| Year End Resources | 2014/15 Actual £m | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|---|
| Fund balances / reserves | 25.228 | 48.967 | 24.117 | 23.577 | 17.126 |
| Capital receipts | 17.570 | 15.006 | 1.291 | 0.000 | 7.146 |
| Provisions | 5.472 | 5.000 | 5.000 | 4.000 | 3.000 |
| Other | 0.845 | 0.000 | 0.000 | 0.000 | 0.000 |
| **Total core funds** | **49.115** | **68.973** | **30.408** | **27.577** | **27.272** |
| Working capital | | 5.000 | 5.000 | 5.000 | 5.000 |
| (Under)/over borrowing | | 9.838 | 0.000 | 0.000 | 0.000 |
| **Expected investments** | | **83.811** | **35.408** | **32.577** | **32.272** |

### 2.5 Affordability prudential indicators

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

### 2.6 Ratio of financing costs to net revenue stream

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

| | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| Non-HRA | (0.37%) | 1.21% | 1.13% | 1.12% | 1.02% |
| HRA | 20.34% | 19.77% | 19.86% | 20.37% | 20.73% |

### 2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and previous 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.

The increase in the 2015/16 estimate reflects the decision to borrow in advance of need. This in turn has reduced the estimates of capital costs in future years by locking into historically low interest rates.

**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** | (£0.65) | 10.24 | (£5.98) | (£10.42) | (£10.83) |

## 2.8 Estimates of the incremental impact of capital investment decisions on housing rent levels

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

There are significant changes shown in the table, which reflects the Governemnts changes to rent policy and associated changes to the Councils new build and investment programme.

**Incremental impact of capital investment decisions on housing rent levels**

| | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **Weekly housing rent levels** | (£1,035) | (£298) | £67 | £150 | (£80) |

## 2.9 HRA ratios

| | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **HRA debt £m** | 351.428 | 349.949 | 346.739 | 350.066 | 353.710 |
| **HRA revenues £m** | 56.476 | 58.010 | 57.584 | 55.674 | 55.411 |
| **Ratio of debt to revenues %** | 622.2 | 603.3 | 602.1 | 628.8 | 638.3 |
| **Number of HRA dwellings** | 10,289 | 10,189 | 10,089 | 9,989 | 9,889 |
| **Debt per dwelling £** | 34,155 | 34,346 | 34,368 | 35,045 | 35,768 |

# 3 Borrowing

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.

## 3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, highlighting any over or under borrowing.

| | 2014/15 Actual £m | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 346.739 | 346.739 | 366.519 | 366.519 | 371.889 |
| Expected change in Debt | 0.000 | 19.780 | 0.000 | 5.370 | 5.712 |
| Other long-term liabilities | 0.188 | 0.188 | 0.188 | 0.188 | 0.188 |
| **Actual gross debt at 31 March** | **346.927** | **366.707** | **366.707** | **372.077** | **377.789** |
| The Capital Financing Requirement | 346.728 | 356.869 | 366.707 | 372.077 | 377.789 |
| **Under / (over) borrowing** | **(0.199)** | **(9.838)** | **0.000** | **0.000** | **0.000** |

There are a number of key indicators to ensure that the Council operates its activities within well-defined limits.

One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The Council complies with this indicator.

### 3.2 Treasury Indicators: Limits to borrowing activity

**The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed.

| Operational boundary | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|
| Debt | 366.519 | 366.519 | 371.889 | 377.601 |
| Other long term liabilities | 0.188 | 0.188 | 0.188 | 0.188 |
| Total | 366.707 | 366.707 | 372.077 | 377.789 |

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

| Authorised limit | 2015/16 Estimate £m | 2016/17 Estimate £m | 2017/18 Estimate £m | 2018/19 Estimate £m |
|---|---|---|---|---|
| Debt | 378.000 | 378.000 | 384.000 | 399.000 |
| Other long term liabilities | 1.000 | 1.000 | 1.000 | 1.000 |
| Total | 379.000 | 379.000 | 385.000 | 400.000 |

The Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently £354.015m.

**Treasury management limits on activity**

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;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

| £m | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|
| **Interest rate exposures** | | | |
| | **Upper** | **Upper** | **Upper** |
| **Limits on fixed interest rates based on net debt** | 100% | 100% | 100% |
| **Limits on fixed interest rates:**<br>• **Debt only**<br>• **Investments only** | <br>100%<br>100% | <br>100%<br>100% | <br>100%<br>100% |
| **Limits on variable interest rates**<br>• **Debt only**<br>• **Investments only** | <br>5%<br>40% | <br>5%<br>40% | <br>5%<br>40% |
| **Maturity structure of fixed interest rate borrowing 2016/17** | | | |
| | | **Lower** | **Upper** |
| Under 12 months | | 0% | 1% |
| 12 months to 2 years | | 0% | 2% |
| 2 years to 5 years | | 0% | 3% |
| 5 years to 10 years | | 2% | 6% |
| 10 years and above | | 5% | 98% |
| **Maturity structure of variable interest rate borrowing 2016/17** | | | |
| | | Lower | Upper |
| Under 12 months | | 0% | 1% |
| 12 months to 2 years | | 0% | 2% |
| 2 years to 5 years | | 0% | 2% |
| 5 years to 10 years | | 0% | 0% |
| 10 years and above | | 0% | 0% |

### 3.3 Borrowing strategy

The Council is currently in a slightly over-borrowed position as described in 3.1. This means that the CFR, has been over funded with loan debt. This was to secure preferential self-financing borrowing rates and maintain General Fund capital balances.

The Corporate Director (Finance & Operations) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, specifically in relation to refinancing, delaying capital expenditure and taking on new borrowings.

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

### 3.4 Policy on borrowing in advance of need

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

Borrowing in advance will be made within the constraints that the Council would not look to borrow more than 36 months in advance of need. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### 3.5 Prospects for Interest Rates

The Councils Treasury Advisors provided the following as their view for interest rates.

| | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.50% | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% |
| 5yr PWLB rate | 2.00% | 2.10% | 2.20% | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% |
| 10yr PWLB rate | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.60% | 3.70% |
| 25yr PWLB rate | 3.40% | 3.40% | 3.50% | 3.60% | 3.70% | 3.70% | 3.80% | 3.90% | 4.00% | 4.00% | 4.10% | 4.10% | 4.10% |
| 50yr PWLB rate | 3.20% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 3.90% | 4.00% | 4.00% | 4.00% |

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have led to forecasts being pushed back for an increase in the Bank Base to quarter 4 of 2016.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- 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 low levels during 2015. Any decisions to avoid new borrowing by running down spare cash balances would need to be carefully reviewed to avoid incurring higher borrowing costs in later years.

- 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.

### 3.6 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 to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling and early repayment of debt will be reported to Cabinet, at the earliest meeting following its action.

# 4 Annual Investment Strategy

## 4.1 Investment policy

The Council's investment priorities will be security first, liquidity second and then return. The strategy generates a list of highly creditworthy counterparties which will also enable diversification and the avoidance of concentration risk.

In order to minimise the risk to investments, the Council clearly stipulates the minimum acceptable credit quality of counterparties for inclusion on the lending list.

The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by the three main ratings agencies (Fitch, Moody's and Standard and Poor's) with a full understanding of what these reflect in the eyes of each agency. These are monitored on a real time basis with knowledge of any changes notified electronically to Dacorum as the agencies notify modifications.

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.

Officers 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 Council will engage with its advisors to monitor market pricing such as "credit default swaps" (CDS) and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Capita Asset Services in producing its colour codings which show the varying degrees of suggested creditworthiness.

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

Investment instruments identified for use in the financial year are listed in appendix 2 under the 'specified' and 'non-specified' investments categories.

## 4.2 Creditworthiness policy

Dacorum uses the creditworthiness service provided by Capita Asset Services. This service employs a modelling approach using credit ratings from the three main credit rating agencies.

The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This approach produces 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 use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (Nationalised or semi nationalised UK Banks only)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of Capita's creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, new investments will not be placed with the counterparty.

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

### 4.3 Country limits

The Section 151 Officer will determine approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent) as appropriate, with durations following the same colour coded criteria, details of which are set out in 4.2. Officers will remove counterparties from this list should ratings change in accordance with this policy, and counterparties will only be added with approval from the Section 151 Officer.

## 4.4 Investment strategy

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

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

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

| Maximum principal sums invested > 364 days | | | |
|---|---|---|---|
| **£m** | **2015/16** | **2016/17** | **2017/18** |
| Principal sums invested > 364 days | 20% of portfolio | 20% of portfolio | 20% of portfolio |

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.

### 4.5 Investment risk benchmarking

These benchmarks are simple guides to minimise risk; so they may be breached from time to time, depending on movements in interest rates and counterparty criteria.

The purpose of the benchmark is that officers will monitor the position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported to Cabinet, with supporting reasons in the mid-year and annual report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to historic default tables is 0.06%.

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £0.25m
- Liquid deposits of at least £5m available with a week's notice.
- Weighted average life benchmark is expected to be 100 days

Yield - local measures of yield benchmarks for investments is to achieve internal returns above the 7 day LIBID rate.

### 4.6 External fund managers

The Council does not currently use fund managers. If deemed appropriate to use fund managers in the future, the decision will be passed through Cabinet for recommendation to Full Council.

## Appendix 1: Economic Background

### UK

The 2015 GDP growth rate is likely to be a leading rate in the G7 again, although it looks likely to disappoint previous forecasts and come in at about 2%.

The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time, (as he confirmed in a speech on 19 January):

Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February.

CPI inflation is expected to get back to around 1% in the second half of 2016 and not get near to 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase.

Recent volatility in financial markets could dampen investment decision making as corporates take a more cautious view of prospects in the coming years due to international risks. This could impact in a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries, so this could well feed through into an increase in consumer expenditure and demand in the UK economy,.

The forecast for the first increase in Bank Rate has been pushed back progressively over the last year from Q4 2015 to Q4 2016 and increases after that will be at a much slower pace, and to much 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.

**CAPITA ASSET SERVICES FORWARD VIEW**

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over time.

Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

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. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.

## Appendix 2: Credit and Counterparty Risk Management

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

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

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

| | *** Minimum 'High' Credit Criteria** | **Use** |
|---|---|---|
| Debt Management Agency Deposit Facility | -- | In-house |
| Term deposits – UK Government (including other local authorities) | -- | In-house |
| Term deposits – banks and building societies –Banks carrying a credit rating and the Cooperative Bank | See 4.2 | In-house |
| UK Government Gilts | UK sovereign rating | In-house and Fund Managers |
| Money Market Funds | AAA | In-house and Fund Managers |
| Cash Fund Management | See 4.2 | In-house and Fund Managers |
| Government Liquidity Funds | See 4.2 | In-house and Fund Managers |
| **Local Authority Mortgage Scheme**<br>Under this scheme the Council placed funds of £2M; £1M of which with Lloyds Banking Group and £1M with Leeds Building Society for a period of 5 years. This is classified as being as service investment, rather than a treasury management investment, and is therefore outside of the specified/ non-specified categories. | | |

**Term deposits with nationalised banks and banks and building societies**

| | *** Minimum Credit Criteria** | **Use** | ***** Max % of total investments** | **Max. maturity period** |
|---|---|---|---|---|
| UK part nationalised banks | See Capita's Creditworthy list | In-house | **12.5M per institution** | **12 months** |

**Non-specified Investments**: These are any investments which do not meet the specified investment criteria. A maximum of the lower of 30%of the portfolio, or £20m will be held in aggregate in non-specified investment

| | *** Minimum Credit Criteria** | **Use** | **Max. maturity period** |
|---|---|---|---|
| Term deposits – UK Government and Other Local Authorities | -- | In-house | 5 years |
| Term deposits – banks and building societies | See 4.2 | In-house | 5 years |
| Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee | UK sovereign rating | In-house | 5 years |
| Certificates of deposit issued by banks and building societies | See 4.2 | In-house | 5 years |
| Fixed term deposits with variable rate and variable maturities<br><br>-Callable deposits<br><br>-Callable range trade accounts | See 4.2 | In-house and Fund Managers | 5 years |
| Short term funds | See 4.2 | In-house and Fund Managers | 5 years |
| Cash Fund Management | See 4.2 | In-house and Fund Managers | 5 years |
| Gilt Funds, Bond Funds and Government Liquidity Funds | See 4.2 | In-house and Fund Managers | 5 years |
| UK Government Gilts | UK sovereign rating | In-house and Fund Managers | 10 years |
| Bonds issued by multilateral development banks | AAA | In-house and Fund Managers | 10 years |
| Corporate Bonds | See 4.2 | In-house and Fund Managers | 10 years |

## Appendix 3: Treasury management roles and scheme of delegation

### Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy**;**
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;

### Cabinet

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

### The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- approving the selection of external service providers and agreeing terms of appointment.
- approving the use of non-UK counterparties as appropriate