APPENDIX 3

Report of the Director
of Policy and Resources

Agenda Item No:
Meeting: 24 February 2015

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

TREASURY MANAGEMENT STRATEGY 2015/16

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1 This report proposes a Treasury Management and Investment Strategy for 2015/16. It has been prepared in line with

- The CIPFA Code of Practice for Treasury Management
- The Prudential Code
- The Local Government Finance Act 2003
- Investment guidance from the Department for Communities and Local Government (CLG)

1.2 The **investment strategy for 2015/2016** aims to reduce risk by

- Limiting the maximum investment period to twelve months
- Applying a maximum investment limit of £7m or lower for counter-parties (except the council's own bankers)
- Applying a maximum limit to financial groups rather than separate institutions
- Investing in a range of financial institutions including UK institutions with a minimum of an adequate credit rating or equivalent and Money Market Funds.
- Investing in additional instruments such as Certificates of Deposit

1.3 The **borrowing strategy for 2015/2016** aims to

- Borrow at the most advantageous point possible
- Track short-and long-term interest rates alongside investment rates to determine that point
- Consider borrowing from a range of institutions to ensure the best value for money
- Generally borrow only to support the capital programme
- Borrow for shorter periods if cash flow requires or to avoid long term borrowing for a period.

2. BACKGROUND INFORMATION

THE LEGAL FRAMEWORK

2.1. CIPFA issued the latest version of the Prudential Code for Capital Finance in 2011. This was supplemented in 2013 by a set of Guidance Notes for Practitioners. This gave practical advice on the interpretation of the code. CIPFA introduced a revised Code of Practice for Treasury Management in 2011.

Code of Practice

2.2. CIPFA's revised code of practice for Treasury Management emphasises that risk management is a fundamental part of a Treasury Management Strategy. The code prioritises the security of the investment above the return achieved. It is not possible to invest without any risk but the selection of appropriate criteria for the selection of counterparties, and limits on the size and duration of investments, can minimise risk.

The Prudential Code

2.3. The prudential code provides a framework to ensure for a particular council that:-

- capital expenditure plans are affordable
- all external borrowing and other long-term liabilities are within prudent and sustainable levels
- treasury management decisions are taken in accordance with professional good practice

2.4. Guidance has also been issued by the Department of Communities and Local Government (CLG). This guidance is in accord with that issued by CIPFA in prioritising the security of the investment first, then liquidity and finally the return on the investment.

THE ECONOMIC CONTEXT

2.5. Since last year's Treasury Strategy report there have been a number of positive signs for the UK and wider economy. For example in the UK Gross Domestic Product (GDP) grew in all four quarters of 2014 although the growth is less than had been anticipated.

Future growth in GDP is a key consideration when determining the Treasury Strategy as it is a primary measure of economic recovery. There has been growth in every period since the first quarter of 2013 but current forecasts of growth are uneven, with growth in 2015 forecast to be less than in 2014. Appendix A shows the latest projections from the Office of Budget Responsibility.

2.6. In January 2015 the Consumer Price index (CPI) fell to 0.5%. It is likely that CPI will remain low and may even become deflation later in 2015. Low inflation tends to encourage consumers to postpone purchasing goods and services and can reduce economic growth. This effect is unlikely to be a major issue unless the period of low inflation or deflation is prolonged.

2.7. Another factor that can affect growth is the price of crude Oil. This currently stands at the same level as it was in 2009 and has been below $50 per barrel. This is due to weak demand coupled with increased US supply and OPECs reluctance to reduce production to limit supply. The low price of oil means that energy prices are likely to decrease and may increase growth.

2.8. The UK's main export market is the Eurozone and there are three issues currently affecting this area which are causes for concern. The Eurozone is currently experiencing deflation which as mentioned above can slow growth due to consumers prioritising saving over spending. The value of the Euro has also been declining especially against the dollar and the recently announced quantitative easing programme is likely to result in it losing a further 10-20% of its value. The recent elections in Greece have led to a change of government which has made clear their intention to renegotiate the terms of the EU/IMF bailout. If agreement cannot be reached there is a possibility that Greece may leave the Euro. In 2012 this eventuality raised the spectre of a financial contagion. The likelihood of either of these events happening is lower than in 2012 but remains a possibility.

2.9. All these factors combine to create an environment when the risk of financial institutions failing is increasing. The main credit rating agencies are rumoured to be considering reducing the credit ratings of a number of banks and building societies which would further limit the council's potential counterparties. In addition the requirement on Banks to retain funds to enhance their ability to survive any future financial crisis may mean that some types of investment may no longer be on offer or may be offered on very low or even negative interest rates.

2.10. ***Short-term interest rates***. The Bank of England has held interest rates at 0.5% since March 2009. Previous forecasts had assumed interest rates would increase in the second quarter of this year. The current economic climate has made this less likely and when rates do eventually rise they are likely to increase gradually as a rapid rise will impact most directly on mortgage holders and will affect the housing market.

2.11. The Office for Budgetary Responsibility assumes that base rates are held at 0.5% in 2014 rising to 0.6% in the third quarter of 2015. Rising to 1.2% by the third quarter of 2016 and 1.6% by the third quarter of 2017.

2.12. Whilst many indicators are showing improvement the council's financial strategy continues to assume short term interest rates will remain at 0.5%.

2.13. **Longer-term interest rates** have fluctuated since April 2010 with 25 year PWLB maturity loans ranging between 3.21% and 5.48%. Long-term fixed interest rates are affected by many factors: the performance of the UK economy, inflation expectations, gilt issuance, sovereign debt ratings and ratings risk.

2.14. The role of the PWLB is to on-lend central government's own borrowing to local authorities to deliver capital investment, while HM Treasury is responsible for determining the methodology used to set the rates at which PWLB transacts.

2.15. The council has qualified to receive PWLB loans at a discounted rate, known as the Certainty rate. Where possible any borrowing will use this rate. Current indicative rates for three types of loan are at historically low levels:

Rates as at 24th Jan 2014	Maturity		EIP		Annuity	
	Rate	Certainty Rate	Rate	Certainty Rate	Rate	Certainty Rate
25 Year	3.17%	2.97%	2.71%	2.51%	2.77%	2.57%
10 Year	2.52%	2.32%	2.02%	1.82%	2.04%	1.84%

2.16. Currently a majority of the council's loans are of the maturity type, where debt is repaid at the end of the loan period, with some inherited debt on the basis of Equal instalments of Principal (EIP) repaid each year. It is proposed that in future annuity loans are considered as an option due to their lower cost and the spreading of the principal repayments over the life of the loan. This would align the repayment profile with the Minimum Revenue Provision (MRP) made in the accounts each year to set aside funding to repay outstanding debt regardless of the timing of external payments.

2.17. The council has always used the PWLB as its lender of choice on value for money grounds. There are other options which should be considered when new borrowing is required. One alternative currently available to the council is the European Investment Bank. This organisation lends to support sound and sustainable investment projects which contribute to furthering EU policy objectives and may be appropriate to support particular investments. A further potential source of future borrowing is the Local Government Association Bond Agency that should become operational early in the new financial year. The council has committed to invest £50,000 in the Bond Agency, of which approximately £20,000 has so far been paid. This investment was required to enable the council to have access to borrowing from this source.

THE CURRENT PORTFOLIO POSITION

Investments

2.18. The council has been operating with a cash surplus for many years, and has used its cash balances to support its capital investment programme to avoid external borrowing for seven consecutive years. Due to the amount of borrowing assumed within the capital programme it is anticipated that the council will need to borrow in 2015/16.

2.19. It is also proposed that borrowing will be used to finance specific schemes in the Property Trading Account where investments will generate a rental income. This income will be used to pay the minimum revenue provision and interest charges resulting from the loan. To ensure the costs of the loan do not vary from that assumed in setting the rent it is proposed to borrow to finance these schemes at an appropriate point in the construction project.

2.20. Investments change on a daily basis. So far in 2014/15 the council has invested on average £38.8m (compared to £40.4m in 2013/14). The minimum amount invested was £13.2m and the maximum amount invested was £54.5m at interest rates averaging 0.44% compared to base rate 0.5%. Estimated cash flows for 2014/2015 are expected to give an average daily balance of £33.9m.

Borrowing

2.21. As noted above, for the past seven years the council has avoided external borrowing by utilising surplus cash balances. This has enabled the council to avoid paying interest on borrowing and keep its cash balance low so minimising risk. While the council has surplus cash and a significant differential between long and short term interest rates exists this strategy remains sensible. However current planned capital spending, and the debt repayment profile, means that borrowing is likely to be necessary in 2015/16 and in subsequent years.

3. OPTIONS FOR CONSIDERATION

3.1. The council has a range of options when determining its ***strategy for investment***. This includes the type of investments it will make, with which institutions and for what term. It must do so within the framework of government legislation which sets limits on the range of investments which can be made, while following the best practice requirements of the Treasury Code of Practice. A key consideration is to determine the portfolio of investments which will be used: to spread risk, maintain liquidity to ensure it can meet obligations to creditors, and maximise return whilst ensuring capital security at all times.

3.2. A similar range of considerations apply to the ***borrowing strategy***. In framing its borrowing policy the council must follow the requirements of the Prudential Code and related guidance issued under the Local Government Act 2003. A key priority is to minimise the cost of borrowing and this will dictate the choice of counterparties, financial instruments and the term of any loan. Generally the council borrows only to meet the cost of its capital programme, although it needs the facility to borrow short-term if cash flows demand (typically at year end).

4. ANALYSIS OF OPTIONS

INVESTMENT STRATEGY

4.1. **Specified investments**. Following guidance issued under s15 (1) (a) of the Local Government Act 2003 these are investments offering high security and high liquidity. An investment is a specified investment if all of the following apply;

(a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
(b) the investment is not a long-term investment i.e.it has a maturity of no more than 12 months;
(c) it does not involve the acquisition of share capital or loan capital in any body corporate;
(d) the investment is made with a body or in an investment scheme which has been awarded an adequate credit rating by a credit agency or is made with:

(i) the United Kingdom Government
(ii) a local authority in England or Wales or similar body in Scotland or Northern Ireland
(iii) Parish council or community council.

4.2. **Non-specified investments**. These are any investments which do not meet the criteria for specified investments. They therefore potentially carry additional risk, e.g. lending for periods beyond 12 months or to bodies which are not highly credit rated. In the current financial markets it is recommended that lending beyond twelve months and lending to bodies with low credit ratings is **not** considered.

4.3. **UK Building Societies**. The building society sector was weakened by the banking crisis. The same requirements in terms of credit ratings should be applied to Building Societies as to Banks before they are included on the council's counterparty list.

4.4. **Money Market Funds (MMF).** Currently MMFs are offering a slightly higher return than typical bank deposits, but fee structures are different. As mutual funds that invest in a portfolio of short term, high quality debt instruments they are considered to be an effective tool to diversify credit risk and interest rate risk, while retaining instant access in the same way as for call accounts.

4.5. **Challenger Banks**. These are new, generally smaller, banks which are challenging the larger banks dominance. There is currently some scepticism about whether they will be successful. The council will only include these banks on its counterparty list if they meet the same criteria as other financial institutions.

4.6. **Certificates of Deposit (CD).** These are savings certificates entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are generally issued by commercial banks. The term of a CD generally ranges from one month to five years. Currently many Local Authorities make use of the market in certificates of deposit as an alternative to cash deposits. There are several reasons for this. The interest rate offered by CDs is competitive, there is a secondary market for CD's making the investment more liquid than equivalent cash deposits and through the use of CD's it is possible to invest in some financial institutions that are on our counterparty list but do require cash investments of a much larger size than this council has available.

4.7. **Counterparty limits.** The Council last conducted an independent review of its limits in 2009/10 following advice on the Strategy commissioned from the brokers Sterling International. These limits were appropriate when the council's counterparty list was more extensive. However, as the counterparty list has decreased in size the limits have caused operational difficulties. For that reason limits were raised in 2013/14.

4.8. To give the council flexibility and best value in its borrowing decisions it may be necessary to borrow funds for capital before they are applied. This will have the effect of increasing cash balances for the short-to medium term. In those circumstances it is important that the council has adequate counterparty limits, and is not constrained to place its fund with the DMO at minimal rates of interest. It is therefore proposed to introduce the ability to invest in certificates of deposit to make more use of the existing counterparty list and therefore retain limits at £7m with the largest banks. It is further proposed to keep the counterparty limit for its own banker at twice that for other large banks i.e. £14m. It is proposed that the other counter-party limits are also kept at the same level to reflect the limited size of the current counterparty list. Specifically that means:

- A ***maximum limit of £7m*** should apply to the highest rated (short –term F2, P-2 and A-2, combined with long – term A-, A3 and A, ('Strong' or higher grade in Appendix B) ***banks and building societies*****.** **A lower limit of £4m** should apply to institutions with lower ratings (short –term F3, P3, A-3) ('Adequate Grade' in Appendix B).

- Banks within the same ownership group are treated as a single counterparty for the purpose of setting limits. ***The maximum investment for the group is therefore £7m.***

- Only UK financial institutions will be considered but this will include all those institutions which pass the Bank of England Stress tests, and are therefore considered part of the UK financial sector.

- It can be difficult to place relatively small deposits with the larger highly rated banks so the counterparty list is applied as appropriate to the Council's needs.

- It is proposed for 2015/2016 that for ***District Councils*** the counterparty limit is increased to ***£5m*** from £3m for ***Parish Councils*** this is set at ***£50k*** and for all ***other UK local authorities*** the limit is increased to ***£7m*** from £5m to reflect the current financial challenges in the public sector.

- A maximum investment limit of £5m in **Money Market Funds** with the highest credit rating.

- No limit is proposed on the amount that can be invested with the **Debt Management Office**, but this facility will be used as a last resort as returns are minimal

- It is proposed that the ability to invest in certificates of deposit (CD) is also added to the strategy. This will enable the council to invest in a liquid investment at a good interest rate with <u>existing counterparties</u> that would not normally be accessible. An investment in CDs in a financial institution would count as a cash investment for counterparty limit purposes. For example an investment of £1m of CDs with a counterparty for which we have a £4m limit would mean only £3m of headroom was available for cash investments with that same institution.

Credit Risk Assessment

4.9. **Credit ratings.** These are the starting point for determining suitable counterparties. No change is proposed in the council's established policy. There remains the potential that some of our current counterparties credit rating may slip below the minimum investment rating of adequate.

The Bank of England carried out a stress test on the major UK Financial Institutions in late 2014. The results were announced in December 2014 and are shown in Appendix B section 2. The Co-operative Bank failed the test with two other financial institutions, Lloyds Banking Group and Royal Bank of Scotland achieving what is seen as a marginal pass. These two institutions have been asked to take further steps to strengthen their financial position.

In line with the bands set out in the Audit Commission paper 'Risk and Return' attached here as **Appendix B section 1,** and in common with practice in other local authorities, investments are only made with institutions with an adequate grade or above, based on the ratings of the three main credit rating agencies.

4.10. As now, where an entity has its credit ratings downgraded so that it no longer meets the Council's criteria, no new investments should be made, and any that can be recalled without loss of interest should be. Where a rating agency announces that the entity is on "rating watch negative" or "on review for possible downgrade" a similar policy is applied. An assessment of the likely change in credit rating will be undertaken and the forecast rating will be used to determine the counterparty limit being applied to this institution. When these warnings are withdrawn new investments can be made after an evaluation of the reasons for the changed opinion.

4.11. To supplement credit ratings the council uses generally available market information, quality press, information on government support for banks and sovereign debt ratings, share prices of banks, audited accounts of banks, and shared knowledge from brokers and other local authorities. The council is also a member of the CIPFA Treasury Management Network which promotes best practice in public sector treasury management through training, sharing peer expertise, and on-line information.

4.12. The criteria for specified investments should therefore be:

- Short-term deposits with UK banks and building societies, which are rated by at least two of the rating agencies and hold as a minimum an “F3” rating from Fitch, a “P-3” rating from Moody’s and an “A-3” rating from Standard and Poor’s combined with an adequate long-term rating as set out in paragraph 4.8.

- Government institutions: In practice this means the Debt Management Office (DMO) and all UK local authorities (as defined by the section 23 of the Local Government Act 2003). Where government bodies offer the same terms as commercial borrowers, the Council should seek to invest first with the government body, due to the reduced risk of default.

- Money Market Funds with the highest credit rating with at least one credit rating agency. That is either rated as AAAMmf with Fitch or rated AAAm with Standards and Poor or rated Aaa-mf with Moody’s.

4.13. A list of counterparties which currently meet these criteria is at Appendix C. It is proposed to continue with the council’s current policy of only directly investing with UK financial institutions due to the additional risks inherent in investing outside the UK. An exception to this was reintroduced last year in the form of Santander UK, an established UK business but without a current listing on the London Stock Exchange. Money Markets Fund’s investment portfolios are diverse and may include an element of foreign investments. Each fund has its own credit rating and investments will only take place with those that meet the required standard. The volatility of credit ratings means that the counterparty list can only be correct at a point in time and urgent decisions on changes may be required. To enable the Treasury Management Service to operate effectively it is proposed that the authority to make changes to the counterparty list is delegated to the Director of Policy and Resources who will report back to members if this authority is used. Such changes would involve banks dropping below “Adequate grade” being removed from the list and any rising from speculative to adequate being added.

4.14. The Council does not have paid external advisors offering advice on the composition of counterparty lists, credit ratings or any other investment advice. However, the Council is aware of the growing complexity of treasury management. All staff involved with treasury management are provided with training to ensure they have the skills and knowledge to meet the demands of the job including an awareness of available sources of funds and investment opportunities appropriate to an authority of this size, an ability to assess and control risk, knowledge of money and capital markets and an appreciation of the implications of legal and regulatory requirements.

4.15. Overall the **investment strategy for 2015/16** aims to reduce risk by

- Investing for up to twelve months.
- Investing in institutions with adequate credit ratings or with equivalent or greater security (DMO, local authorities)
- Applying a maximum limit of £7m (except the council's bank, £14m and the DMO)
- Applying the limit on the banking group not the individual institution
- Only directly investing in UK financial institutions
- At the same time keeping an appropriate maturity profile of investments to minimize exposure to liquidity risk and interest rate risk.
- Increasing its available options with existing counterparties by investing in Certificates of Deposit.

BORROWING STRATEGY

4.16. The council's current level of debt is £105.8m, after repayment of maturing debt of £1.2m in 2013/14 and £0.5m to date in 2014/15. Future repayments will be £1.5m in 15/16, £2.4m in 16/17, £9.6m in 17/18 and £0.6m in 18/19. **The borrowing requirement** for the proposed capital programme is £15.6m in 2015/16, £4.9m in 2016/17, £2.5m in 2017/18 and £0.3m in 2018/19. The combined effect of these two cash payment streams along with a general reduction in surplus cash is that the council will be unable to continue its current policy of internal borrowing much longer. As an alternative to long term borrowing short term options should be considered.

4.17. **Criteria for borrowing decisions**. Council borrowing has previously focussed on 25 year fixed interest maturity loans provided through the PWLB as providing best value in the long-run. The Public Works Loan Board (PWLB) is a statutory body operating within the UK Debt Management Office, an executive agency of H M Treasury. Its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments. In future it is proposed to consider the other options available to the council both in terms of other forms of loans (Equal Instalments of Principal and Annuity loans) and other counterparties. Currently the main alternative to the PWLB is the European Investment Bank but the Local Government Association's Bond Agency will become operational shortly. For cash flow purposes there is also the option of borrowing from other local authorities.

4.18. The council's current policy of deferring borrowing is unlikely to be sustainable beyond the current financial year. This is because there has been a general reduction in surplus cash balances, which in part reflects an increased call on reserves to support the budget. It is also likely that the differential between short and long term interest rates will widen as markets anticipate an increase in bank base rates.

4.19. There is a trade-off between short, medium and long term financial benefits of delayed borrowing. Whilst cash balances are available their use to avoid borrowing produces a saving in interest payments, similarly borrowing short term rather than long term provides savings as long term rates are currently higher. A longer term view would be to lock into the historically low long term interest rates before they begin to rise. However as can be seen from the economic context at paragraph 2.5 there remains a high degree of risk and uncertainty in the financial markets. Therefore the decision whether to borrow and for what period will require judgement. The position will be kept under review.

4.20. A key issue is the scale of capital investment the council chooses to make. On past experience the need has been greater than the resource the council could secure through grant and private sector contributions or generate through the sale of surplus assets. If the council wishes to invest more in its assets then there will be a need to borrow. How much it is prudent to borrow depends on the headroom it can create by reducing the direct costs of running services or increasing its income, and the price it has to pay for that borrowing.

4.21. **Operational leases** were historically the preferred funding method for vehicles, plant and some small items of equipment on value for money grounds. For the past few years the policy has been to use capital receipts to cover the cost of new vehicle purchases. This strategy minimises the revenue cost to the council.

4.22. **Finance Leases**. When International Financial Reporting Standards were introduced some leases that were previously classified as operational were reclassified as Finance Leases. The accounting requirements for these leases are the same as if the council had purchased the asset and financed it from borrowing. This form of financing does not currently offer value for money.

4.23. **Counterparties**. As indicated earlier the council has normally used the PWLB but other lenders should be considered to ensure value for money.

4.24. **Use of LOBOs and structured debt.** No use of these financial instruments is proposed.

4.25. **Limits on fixed and variable debt.** Use of variable debt is one way of reducing exposure to interest rate risk as rates tend to move in line with money market rates. There is no proposal to change the limits for variable debt, but the option should be considered as part of the wider borrowing and investment strategy.

4.26. **Limits on maturity.** An ideal borrowing strategy aims for an even profile of maturing debt, to minimise exposure to refinancing risk. This will be a guiding principle as the council resumes external borrowing. This can also limit the scale of the debt burden. At the same time the borrowing term should be matched to the likely life of the asset being financed. It is therefore proposed that all options are considered: the term of the loan, whether fixed or variable, and the basis of repayment, at term, using an annuity or by equal annual instalments. New borrowing should aim for an average interest rate below 5%. The money market can occasionally provide funds that undercut PWLB levels and this option should be considered in that context.

4.27. **Debt rescheduling**. A premium is charged when repaying debt, which has an effective interest rate above the current market rate. The size of the premium is such that it removes any financial benefit from the rescheduling of debt. The council will continue to monitor the situation but unless the premiums being charged reduce significantly no rescheduling of debt will be undertaken.

4.28. **Minimum Revenue Provision.** The Council is required to make a prudent revenue provision to repay capital spend that is financed by borrowing. This is called the Minimum Revenue Provision (MRP). Where capital expenditure is not resourced immediately (as in the current policy of deferred borrowing), this results in a net increase to the capital financing requirement and represents an increase in the underlying need to borrow for a capital purpose. An MRP provision is required whether or not external borrowing actually occurs.

Full Council is required to approve an MRP Policy in advance of each financial year. The Council is recommended to reaffirm the following statement which ensures that the estimates make a prudent provision in line with requirements:

North Lincolnshire Council will make prudent minimum revenue provision for all borrowing. For all supported borrowing the council will use the CFR method. This calculation is based on the concept of the Capital Financing Requirement (CFR), which can be derived from the balance sheet: MRP is equal to 4% of the CFR at the end of the preceding financial year. For all new borrowing under the Prudential system the Council will make provision either in equal instalments over the estimated life of the asset for which the borrowing is undertaken or the annuity method where the set aside increases over the life of the asset. The decision on which approach to take will be made on a scheme by scheme basis.*

4.29. **Prudential indicators.** The Prudential Code sets out prudential indicators that must be used, and factors that must be taken into account to show that the council is fulfilling the aims of the code. The indicators are not intended to be comparative with other local authorities and the Code does not include suggested limits or ratios. They are designed to support and record local decision-making in a manner that is publicly accountable.

The proposed indicators are set out at Appendix C and in the Capital Report elsewhere on this agenda. They set limits on the maximum level of borrowing which may be made in the financial year, but can be revised by council if necessary at a later date. The limits have been set so as to allow borrowing to meet the needs of the capital programme, with an allowance for contingencies should adverse factors affect normal cash flow. They also set parameters for the maturity structure of debt and the mix of fixed and variable debt.

4.30. The Prudential Code requires the Director of Policy and Resources to monitor all prudential indicators. Regular monitoring is undertaken in-year against all prudential indicators. Significant variation in the estimates used to calculate these prudential indicators would trigger a report to the Director of Policy and Resources, which would lead to further investigation and action as appropriate.

4.31. Internal monitoring underpins reporting to Council, Cabinet and the Audit Committee. This is done at the special meeting of Council to set the council tax (strategy approval); on the closure of accounts in June; and mid-year. Cabinet receives treasury monitoring information as part of the budget review reports during the year. These are generally in June (outturn), September/October and January. The Audit Committee receives reports at its quarterly meetings.

4.32. The proposed **borrowing strategy for 2015/2016** is therefore:

- To plan to borrow for capital purposes
- To aim to borrow only to support the cost of the capital programme, net of the Minimum Revenue Provision
- Retaining the option to borrow for cash flow purposes or to avoid long-term borrowing for a period should this be necessary
- To borrow for capital investment purposes at a time which is most advantageous on cost. The Council will not normally borrow more than or in advance of its needs. Any decision to borrow in advance will be considered carefully to ensure value for money and that the Council can ensure security of such funds
- To borrow at the most appropriate mix of loans (whether fixed interest, variable interest, maturity, annuity or EIP) and from the most appropriate counterparty and best value for money option
- To only consider debt rescheduling if the cost of premiums significantly decrease.

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)

5.1. Financial

The financial implications of this report are reflected in the 2015/19 financial plan and capital programme presented elsewhere on this agenda.

6. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

6.1. **Statutory**

Statutory and best practice requirements are taken into account when framing the Treasury Management Strategy

6.2. **Risk**

Managing risk is a key element of the treasury strategy and is addressed in the body of the report.

7. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

7.1. Consultation not required. No known conflicts of interest.

8. RECOMMENDATIONS

8.1. That council approve

a) The Treasury Management Investment and Borrowing Strategy for 2015/16

b) The prudential indicators for 2015/18 at Appendix D

c) The policy on the Minimum Revenue Provision.

d) That council approves the current list of approved financial institutions at **Appendix C** and delegates to the Director of Policy and Resources the authority to make changes to the list as necessary, within the guidelines set by the Treasury Strategy. Any changes to be reported back to Council, Cabinet and Audit Committee as part of the regular reporting process.

DIRECTOR OF POLICY AND RESOURCES

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Background Papers used in the preparation of this report

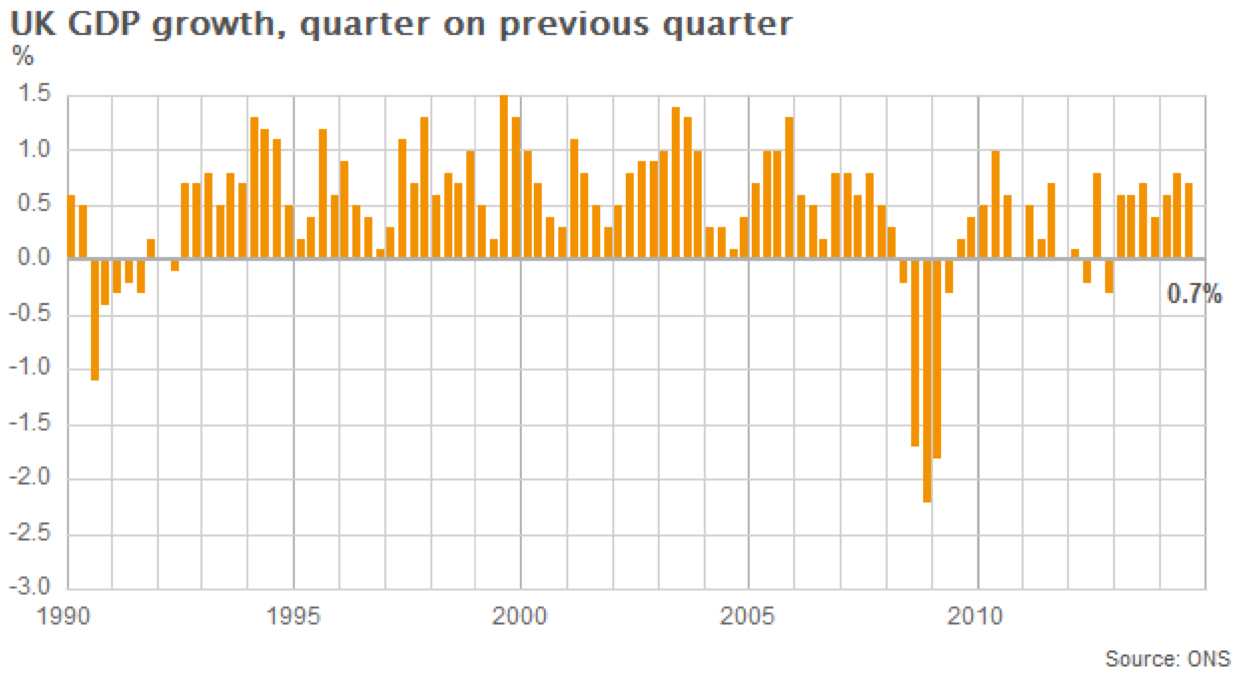
CIPFA Treasury Management in the Public Services: Code of Practice 2011
CIPFA The Prudential Code Second Edition 2011
DCLG Guidance
Local Government Act 2003

ECONOMIC INDICATORS

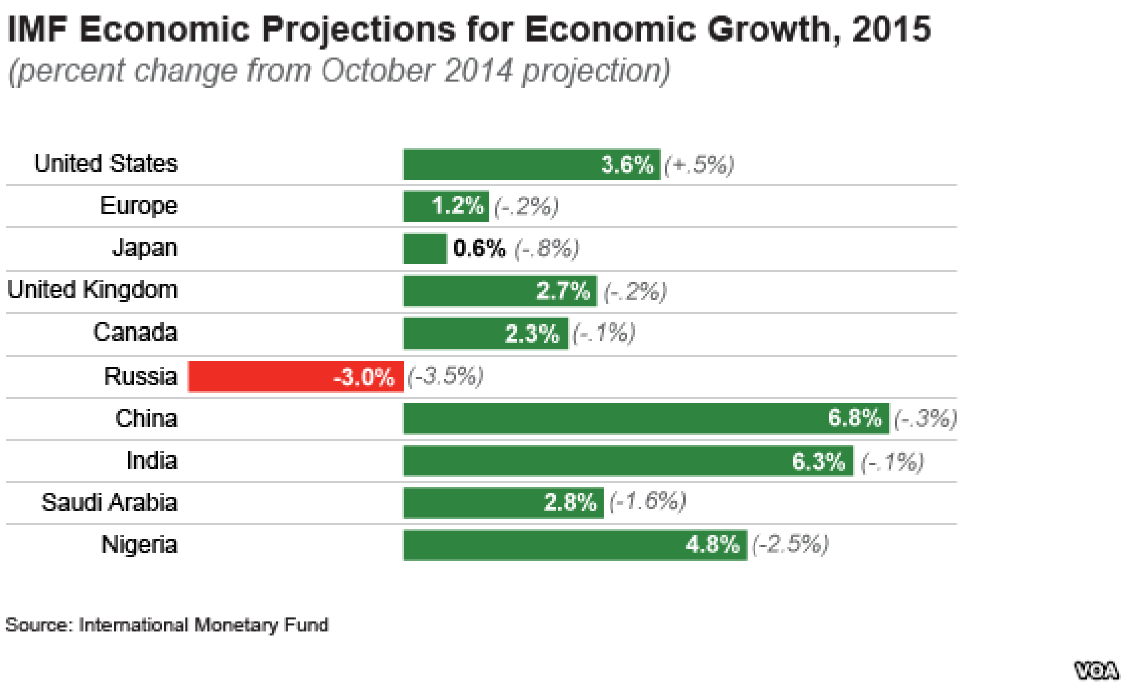
Appendix A

1) GDP GROWTH

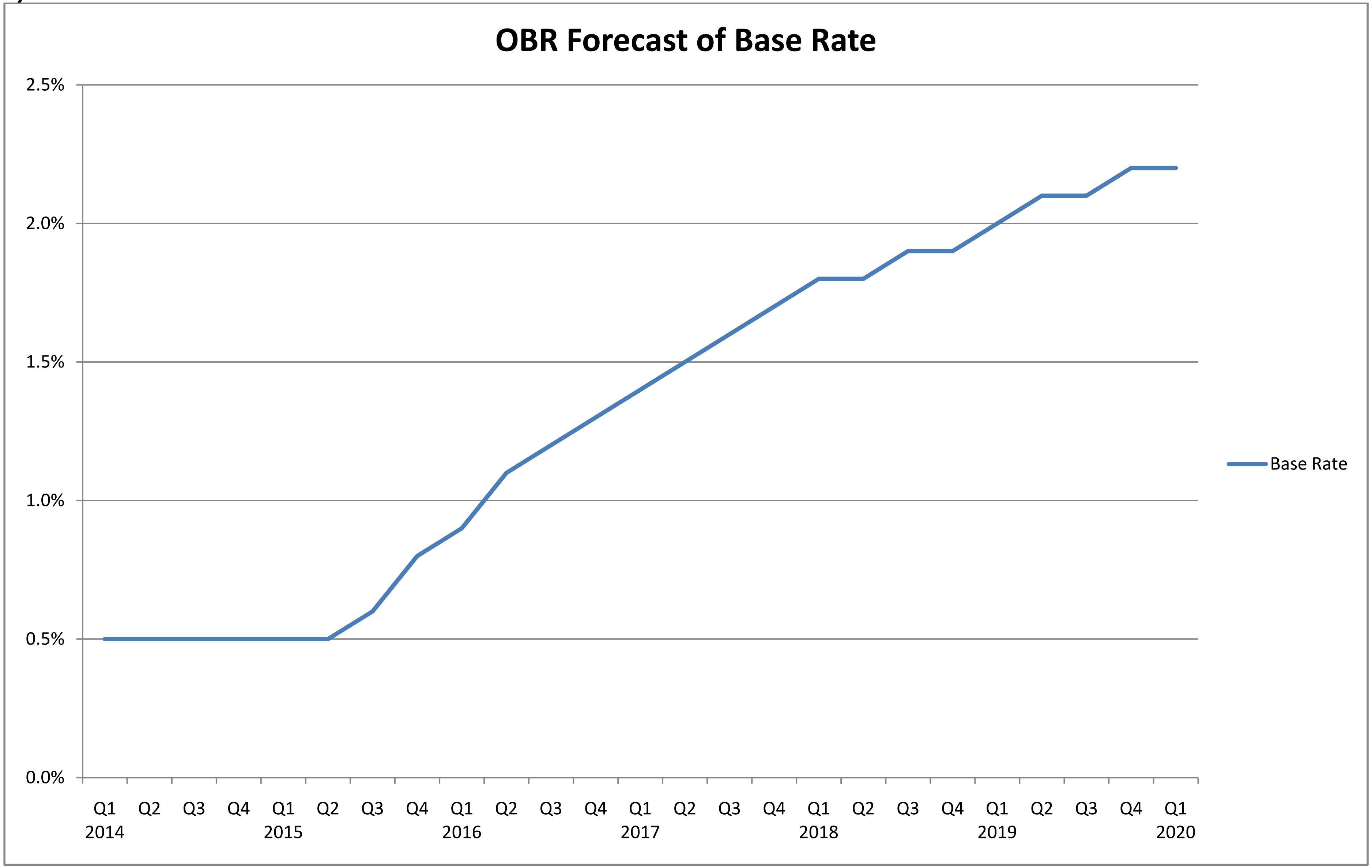
	Forecast Per cent						
OBR (Dec 2014)	**2013 (Actual)**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Gross domestic product (GDP)	**1.7**	**3.0**	**2.4**	**2.2**	**2.4**	**2.3**	**2.3**



2)
IMF Forecast of GDP growth for selected economies



3)


OBR Forecast of Base Rate
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
Q1 2014
Q2
Q3
Q4
Q1 2015
Q2
Q3
Q4
Q1 2016
Q2
Q3
Q4
Q1 2017
Q2
Q3
Q4
Q1 2018
Q2
Q3
Q4
Q1 2019
Q2
Q3
Q4
Q1 2020
Base Rate

CREDIT RISK

Appendix B

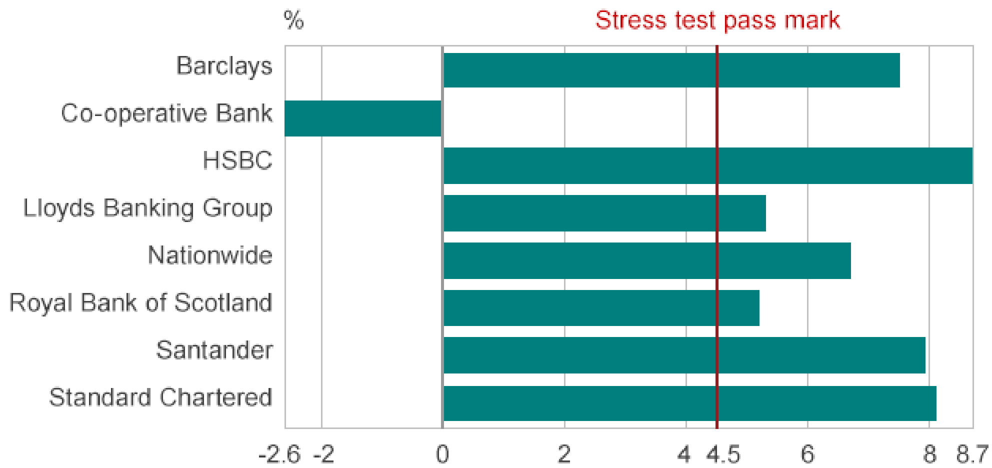
1) Credit Ratings

Audit Commission grading (for the purpose of standardisation)'	Fitch		Moody's		Standard and Poor's	
	Long term	Short term	Long term	Short term	Long term	Short term
Extremely strong grade	AAA	F1+	Aaa	P-1	AAA	A-1+
Very strong grade	AA+	F1+	Aa1	P-1	AA+	A-1+
	AA	F1+	Aa2	P-1	AA	A-1+
	AA-	F1+	Aa3	P-1	AA-	A-1+
Strong, but susceptible to adverse conditions grade (strong grade)	A+	F1+ F1	A1	P-1	A+	A-1+ A-1
	A	F1	A2	P-1 P-2	A	A-1+
	A-	F1 F2	A3	P-1 P-2	A	A-1+ A-2
Adequate grade	BBB+	F2	Baa1	P-2	BBB+	A-2
	BBB	F2 F3	Baa2	P-2 P-3	BBB	A-2 A-3
	BBB-	F3	Baa3	P-3	BBB-	A-3
Speculative grade	BB+	B	Ba1	Not prime (NP)	BB+	B-1
	BB	B	Ba2	NP	BB	B-2
	BB-	B	Ba3	NP	BB-	B-3
Very speculative grade	B+	B	B1	NP	B+	-
	B	B	B2	NP	B	-
	B-	B	B3	NP	B-	-
Vulnerable grade	CCC	C	Caa1	NP	CCC+	C
	CCC	C	Caa2	NP	CCC	C
	CCC	C	Caa3	NP	CCC-	C
	CC	C	-	NP	CC	C
	C	C	Ca	NP	C	C
Defaulting grade	D	D	C	NP	D	D

Source: Audit Commission adaptation of information from Fitch, Moody's and Standard and Poor's

2) Stress Test Results

How banks fared in the stress test



Source: Bank of England

COUNTERPARTY LIST **APPENDIX C**

BANKS	**Fitch**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	ST	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
United Kingdom							
Barclays Bank	F1	A	P-1	A2	A-1	A	£14,000,000
HSBC Bank plc	F1+	AA-	P-1	Aa3	A-1+	AA-	£7,000,000
Santander UK	F1	A	P-1	A2	A-1	A	£7,000,000
Standard Chartered Bank	F1+	AA-	P-1	A1	A-1	A+	£7,000,000
Lloyds Banking Group							£7,000,000
Bank of Scotland	F1	A	P-1	A1	A-1	A	
Lloyds Bank	F1	A	P-1	A1	A-1	A	
RBS Group							£4,000,000
National Westminster Bank	F1	A	P-2	Baa1	A-2	A-	
Royal Bank of Scotland	F1	A	P-2	Baa1	A-2	A-	

BUILDING SOCIETIES	**Fitch**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	ST	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
Nationwide	F1	A	P-1	A2	A-1	A	£7,000,000
Coventry	F1	A	P-2	A3			£7,000,000
Leeds	F1	A-	P-2	A3			£7,000,000
Yorkshire	F1	A-	P-2	Baa1			£4,000,000
Principality	F2	BBB+	P-3	Baa3			£4,000,000
Skipton	F2	BBB	P-3	Baa3			£4,000,000
GOVERNMENT INSTITUTIONS							
Debt Management Office							Unlimited
Local authorities							
Parish Councils							£50,000
District Council's							£4,000,000
All Other LA's							£7,000,000
Fire Authorities							£5,000,000
Police authorities							£5,000,000

MONEY MARKET FUND	**Fitch**	**Moody's**	**Standard & Poor's**	**Counterparty Limit**
Funds rated by at least one agency as:	AAAMmf	Aaa-mf	AAAm	£5,000,000

NOTE: Credit Ratings correct at 9 February 2015.

Prudential Indicators for 2015/16 to 2017/18 Appendix D

Adoption of the CIPFA Code of Practice

The first prudential indicator is that the Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Service. It was adopted by the Council in October 2002, and as subsequently revised in 2011.

Authorised Limit

The Council is asked to approve authorised limits for its total external debt gross of investments for the next three financial years.

Authorised limit for external debt	**2015/2016**	**2016/2017**	**2017/18**
	£'000	**£'000**	**£'000**
Borrowing	245,000	243,000	238,000
Other Long Term Liabilities	5,000	5,000	5,000
TOTAL	250,000	248,000	243,000

These authorised limits are consistent with the Council's current commitments and Capital strategy. They represent the worst case scenario.

Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

Operational Boundary

The proposed operational boundary for external debt is based on similar estimates to the authorised limit. It reflects the maximum external debt projected by the estimates but reflects a prudent and not worst case position. In practice this limit is unlikely to be breached.

Operational boundary	**2015/2016**	**2016/2017**	**2017/18**
	£'000	**£'000**	**£'000**
Borrowing	193,000	191,000	186,000
Other Long Term Liabilities	2,000	2,000	2,000
TOTAL	195,000	193,000	188,000

Actual External Debt

The prudential indicator for actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt will reflect the actual position at one point in time. This prudential indicator will be the closing balance for actual gross borrowing plus other long term liabilities taken directly from the balance sheet. Actual external debt at 31 March 2014 was £107.8m (£109m 31 March 2013).

Interest Rate Exposure

The Council must set an upper limit on its fixed interest rate exposures and an upper limit on its variable rate exposures. No change is proposed to current limits.

	2014/2015	2015/2016	2016/17
	%	%	%
Upper limit for fixed rate exposure	100	100	100
Upper limit for variable rate exposure	20	20	20

Maturity Structure of Borrowing

The Council must set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowing. No changes are proposed to current limits.

Maturity structure of borrowing	Upper Limit	Lower Limit
Under 12 months	15%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	25%

Total principal sums invested for periods longer than 365 days.

The Council does not plan to invest, for periods longer than 365 days.