City of Westminster

Cabinet

Date:	22 February 2016
Status:	For General Release
Title:	Treasury Management Strategy for 2016/17 to 2020/21
Wards Affected:	All
Financial Summary:	The Annual Treasury Management Strategy sets out the Council's strategy for investing its cash balances, and borrowing within appropriate risk parameters. The Council's investment priorities are to ensure the security of capital, the liquidity of its investments and an optimum return on its investments commensurate with proper levels of security and liquidity, while financing the Council's capital programme and ensuring that cash flow is properly planned. As per the Prudential Code the Council's capital investment plans are prudent, affordable and sustainable.
Report of:	Steven Mair, City Treasurer

1. EXECUTIVE SUMMARY

1.1. This report sets out the Council's Treasury Management Strategy for the period 2016/17 to 2020/21 for Council to approve. The Housing, Finance and Corporate Services Scrutiny Committee has previously reviewed an early draft version prepared in advance of the capital programme being finalised. This report reflects the finalised capital programme.

1.2. The Council is required to operate a balanced budget and, in pursuit of this objective, the Council operates a Treasury Management Function which manages the Council's cash flows, lending and borrowing activities and the control and mitigation of the risks associated with these activities. The borrowing facilitates the funding of the Council's capital programme.

1.3. The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code, the Department for Communities and Local Government (DCLG) Minimum Revenue Provision Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

2. RECOMMENDATIONS

Cabinet is asked to recommend to Council to approve;

(i) The prudential Indicators;
(ii) The Minimum Revenue Provision Policy set out in paragraph 8.7;
(iii) The treasury limits for 2016/17 to 2020/21 as detailed in paragraph 9.6;
(iv) The borrowing strategy set out in section 10
(v) Limits to interest rate exposures and upper and lower limits on borrowing set out in paragraph 10.10 (table10);
(vi) Investment strategy set out in section 11 ; and
(vii) The Investments schedule (Appendix 1).

3. REASONS FOR DECISIONS

3.1. To comply with the Local Government Act 2003, other regulations and guidance and to enable the continued effective operation of the Treasury Management function and ensure that all Council borrowing is prudent, affordable and sustainable.

4. BACKGROUND INFORMATION

4.1. Treasury management is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."[1]

4.2. 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.

4.3. 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.

5. CIPFA REQUIREMENTS

5.1. The Council has formally adopted CIPFA's Code of Practice on Treasury Management (revised November 2011). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

[1] CIPFA Code of Practice or Treasury Management in the Public Services

6. REPORTING AND GOVERNANCE REQUIREMENTS

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

(i) **Treasury management strategy statement and prudential indicators report** (this report). This 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).

(ii) **Mid-year treasury management report -** This will update members with the progress of the capital position, amending prudential indicators as necessary, and identifying whether the treasury strategy is meeting the objectives or whether any policies require revision.

(iii) **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.

6.2. The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Housing, Finance and Corporate Services Policy and Scrutiny Committee.

6.3. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and treasury management practices to the Section 151 officer.

6.4. Further details of responsibilities are given in Appendix 2.

6.5. The CIPFA Code requires the responsible financial officer (i.e. the s.151 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 as part of the Learning and Development programme. The officers attend various seminars and conferences throughout the year. As part of developing financial management training programme Member training will be a priority in 2016/17.

7. TREASURY MANAGEMENT STRATEGY

7.1. The strategy covers Prudential Indicators (PIs) required by the Prudential Code as summarised in the four main areas detailed below:

(i) Capital

- (i) PI 1 Capital expenditure plans;
- (ii) PI 2 Capital Financing Requirement (CFR);
- (iii) PI 3 Affordability – Ratio of Financing cost;
- (iv) PI 4&5 Affordability – Incremental impact of capital investment decisions on council tax and housing rents; and
- (v) The Minimum Revenue Provision (MRP) policy.

(ii) Treasury Management Strategy:
   (i) The current treasury position;
   (ii) PI 6 Net Debt and Capital Financing Requirement;
   (iii) PI 7a Authorised borrowing limit;
   (iv) PI 7b Operational boundary limit;
   (v) PI 7c HRA debt limit; and
   (vi) Prospects of interest rates.

(iii) Borrowing strategy;
   (i) PI 8 Interest rate exposure for debt and variable rate debt;
   (ii) PI 9 Maturity structure of debt;
   (iii) PI 10 Surplus funds invested;
   (iv) Policy on borrowing in advance of need; and
   (v) Debt rescheduling.

(iv) Annual Investment Strategy
   (i) Investment policy;
   (ii) Creditworthiness policy;
   (iii) Current Investment types;
   (iv) Specified and Non-specified investments;
   (v) Country of Domicile; and
   (vi) Investment Strategy

8. CAPITAL PRUDENTIAL INDICATORS 2015/16 TO 2020/21

8.1. The Council's capital expenditure plans are the key drivers of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members' overview of the Council's capital plans to ensure that the investment plans are affordable, sustainable and prudent.

8.2. As demonstrated through this report, the prudential indicators and wider governance processes covering the capital programme the Council's capital plans and budgets are prudent, affordable and sustainable.

8.3. Linked to the above the Council is continuously reviewing the capital programme and its financing in accordance with new and emerging priorities and the current challenging financial climate. This is to ensure that it maintains prudent financing of the programme combined with delivering a programme which is priority driven and which meets the needs of the City.

8.4. **PI 1 Capital Expenditure Plans**

This PI summarises the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle and how these are to be financed by capital or revenue resources.

Over the five year forward forecast of the capital programme, the Council is anticipating generating £871.4m of capital receipts from its disposal programme. The funding of the capital expenditure plans set out in Table 1 below plans:

- to apply capital receipts to capital projects with a relative short-life of up to 15 years, and to borrow (either internally or externally) for longer-life assets (i.e. those with an asset life of 40 years);

- maintain a prudent buffer of capital receipts unapplied of £20m in the event of slippage in the disposal programme; and
- for a minimum balance of £50m of unapplied capital receipts at the end of the five year programme in order to ensure that any short-life assets in the following five-year plan can be funded.

Table 1	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate	Total
	£m	£m	£m	£m	£m	£m	£m
Expenditure							
General Fund	93.48	351.29	359.16	345.71	247.60	416.33	1,813.57
HRA	61.48	81.46	76.02	86.84	34.75	81.28	421.83
TOTAL	**154.96**	**432.75**	**435.18**	**432.55**	**282.35**	**497.61**	**2,235.40**
Funding:-							
Grants & Contributions	58.98	106.93	69.92	68.75	8.26	9.94	322.78
Capital receipts - GF	36.30	108.10	33.25	43.28	343.09	354.75	918.77
Capital receipts - HRA	8.43	41.87	15.47	42.46	4.83	54.10	167.16
Revenue financing	27.53	8.95	24.31	7.88	4.53	4.41	77.61
Major Repairs Allowance	21.42	22.77	22.77	22.77	22.77	22.77	135.27
TOTAL	**152.66**	**288.62**	**165.72**	**185.14**	**383.48**	**445.97**	**1,621.59**
Net financing need for the year	**2.30**	**144.13**	**269.46**	**247.41**	**-101.13**	**51.64**	**613.81**

8.5. **PI 2 Capital financing Requirement**

(i) The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or capital resources. Essentially it measures the Council’s underlying borrowing need. Each year, the CFR will increase by the amounts of new capital expenditure not immediately financed.

(ii) 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 asset’s life. Therefore, the CFR is reduced by this provision to repay debt.

(iii) The CFR also includes an amount equivalent to outstanding liabilities in respect of PFI and other finance leases. Whilst these increase the CFR, and therefore the Council’s borrowing requirement, these types of scheme include a funding facility and so the Council is not required to borrow separately for these schemes. The Council currently has £15m of such schemes within the CFR.

Table 2	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
CFR as at 31 March	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
General Fund	175.19	327.45	591.22	832.95	813.40	793.83
HRA	278.70	284.90	284.90	284.90	284.90	284.90
TOTAL	**453.89**	**612.35**	**876.12**	**1,117.85**	**1,098.30**	**1,078.73**

(iv) Table 2 above shows that the CFR will increase over the medium term. Consequently the capital financing charge to Revenue will increase, reflecting the capital spending plans.

8.6. **Affordability Prudential Indicators**

(i) The objective of the affordability PIs is to ensure that the level of investment in capital assets proposed remains within sustainable limits, and in particular, the impact on the Council's "bottom line" as reflected in the impact on council tax and rent levels.

(ii) **PI 3 Ratio of financing costs to net revenue stream**: identifies the trend in the net capital financing costs against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this report.

Table 3	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%	%
General Fund	2.39	2.76	2.75	6.63	15.65	15.30
HRA	26.49	26.09	26.39	26.96	26.61	26.23

(iii) **PIs 4 & 5 Incremental impact** of new capital investment decisions on council tax and housing rents. The PI identifies the revenue costs arising from proposed capital programme as set out in Table 4 below.

Table 4	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£	£
Incremental impact of capital investment decisions						
Increase/(decrease) in Council Tax (band D) per annum	-	39.81	78.64	131.26	(20.1)	33.9
Increase/(decrease) in average housing rent per week	(0.3)	0.59	0.40	0.43	0.75	0.78

(iv) The City Treasurer reports that the capital programme is affordable over the medium term subject to services keeping to budget and minimal slippage in the programme of capital disposals.

8.7. Minimum Revenue Provision (MRP) Policy

(i) Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year. The CFR measures the extent to which capital expenditure has not yet been financed (i.e. from capital receipts, grants, contributions or revenue) and must therefore, be financed from borrowing. Local authorities are required to charge to council tax an annual sum to repay such debt, which is referred to as the Minimum Revenue Provision. This effectively spreads the cost of paying for the financing of capital expenditure over the period such assets are used to provide services.

(ii) Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended (Statutory Instrument (SI) 3146/2008) requires local authorities to set aside a prudent amount of MRP. In setting this local authorities are required to "have regard to" the "Guidance on Minimum Revenue Provision" issued by the Secretary of State in February 2012.
The Guidance has statutory force and requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.
The Council is recommended to approve the following MRP Statement:

- For capital expenditure incurred before 1 April 2007, MRP will be calculated using Option 1 (the 'Regulatory Method') of the CLG Guidance on MRP. Under this option MRP will be 4% of the closing non-HRA CFR for the preceding financial year.

- For all capital expenditure incurred after 1 April 2007 financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon the asset life method under Option 3 of the DCLG Guidance.
- In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.
- Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.
- As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.
- Charges included in annual PFI or finance leases to write down the balance sheet liability shall be applied as MRP.
- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

9. Treasury Management Strategy

9.1. **Current treasury position –** The latest position on actual borrowings and investments is as shown below:

Table 5	**As at 31 December 2015**		**As at 31 March 2015**	
	Principal	**Average Rate**	**Principal**	**Average Rate**
	£m	**%**	**£m**	**%**
Investments				
Specified	822.8		569.7	
Non - specified	35.8		34.9	
Total Investments	**858.6**	**0.67**	**604.6**	**1.11**
Borrowing				
Public Works Loan Board	211.0	4.58	213.3	4.63
Market Loans	70.5	5.09	70.0	5.08
Total Debt	**281.5**	**4.71**	**283.3**	**4.74**

9.2. The cash balances have increased by £254m in the past nine months which is mainly due to income such as business rates and capital grants received in advance of expenditure.

9.3. A Key PI under the Prudential Code is that gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current year 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.

9.4. **PI6 Net debt and the Capital Financing Requirement -** Table 6 below confirms that the Council's actual and forecast borrowing levels will remain within the forecast CFR in line with statutory requirements and the Prudential Code.

Table 6	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Gross Projected Debt	281.50	257.50	257.50	495.42	494.29	645.93
CFR 31st March	453.89	612.35	876.12	1,117.85	1,098.30	1,078.73
Under / (over) borrowing	172.39	354.85	618.62	622.43	604.01	432.80

9.5. The City Treasurer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future.

9.6. **Limits on authority to borrow**

(i) The Prudential Code requires the Council to set two limits on its total external debt including other long-term liabilities (such as service concessions and finance leases) referred to as the authorised limit and the operational boundary.

(ii) **PI 7a Authorised Limit for External Debt** – This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

(iii) **PI 7b Operational Boundary** – This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years.

Table 7	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
PI 7a Authorised Limit for external debt						
Borrowing and other long term liabilities	454	612	876	1,118	1,098	1,079
PI 7b Operational Boundary for external debt						
Borrowing	282	258	258	495	494	646
Other long term liabilities	15	12	11	11	11	10
Total	297	270	269	506	505	656

(iv) **PI 7c HRA Debt Limit –** In addition Council borrowing for the HRA has to remain within the HRA Debt Limit which was prescribed under the HRA self-financing determinations 2012. Borrowing for the HRA is measured by the HRA CFR. See Table 8 below.

Table 8	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
HRA Debt Limit	334	334	334	334	334	334
HRA CFR	279	285	285	285	285	285
Headroom	55	49	49	49	49	49

(v) The City Treasurer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future.

Prospects for Interest Rates

9.7. Current interest rates and the future direction of both long term and short term interest rates have a major influence on the overall treasury management strategy and affects both investment and borrowing decisions.

9.8. During 2015, the American economy made a strong comeback after a weak first quarter's growth of +0.6%, to grow by 3.9% in quarter 2, but then weakened again to 1.5% in quarter 3. Concerns about a slowdown in growth in China and Japan and the consequent impact for major commodity suppliers in other countries, led to the Federal Reserve's decision to postpone an increase in interest rates in Autumn 2015. A strong improvement on the US domestic employment market in October was the trigger for the Federal Reserve to finally increase rates by a quarter point of one percent. However continuing concerns about global markets, heavily influenced by the uncertainty about the Chinese economy suggests that the Federal Reserve is only likely to increase rates once in 2016, possibly as late as September.

9.9. In January 2015 the European Central Bank (ECB) started a €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EuroZone (EZ) countries intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth was sluggish during 2015 at around 0.4% to 0.5% per quarter. The recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

9.10. The slowing UK growth, low inflation, collapsing oil prices and a weaker global economy has meant that the Monetary Policy Committee is in no hurry to follow America's lead and raise interest rates. Prediction of a first rate rise has now drifted out to the fourth quarter of 2016 as detailed in Table 9 below.

Table 9	Bank Rate	PWLB Borrowing Rate %			
	%	5 year	10 year	25 year	50 year
Q1 2016	0.50	2.00	2.60	3.40	3.20
Q2 2016	0.50	2.10	2.70	3.40	3.20
Q3 2016	0.50	2.20	2.80	3.50	3.30
Q4 2016	0.75	2.30	2.90	3.60	3.40
Q1 2017	0.75	2.40	3.00	3.70	3.50
Q2 2017	1.00	2.50	3.10	3.70	3.60
Q3 2017	1.00	2.60	3.20	3.80	3.70
Q4 2017	1.25	2.70	3.30	3.90	3.80

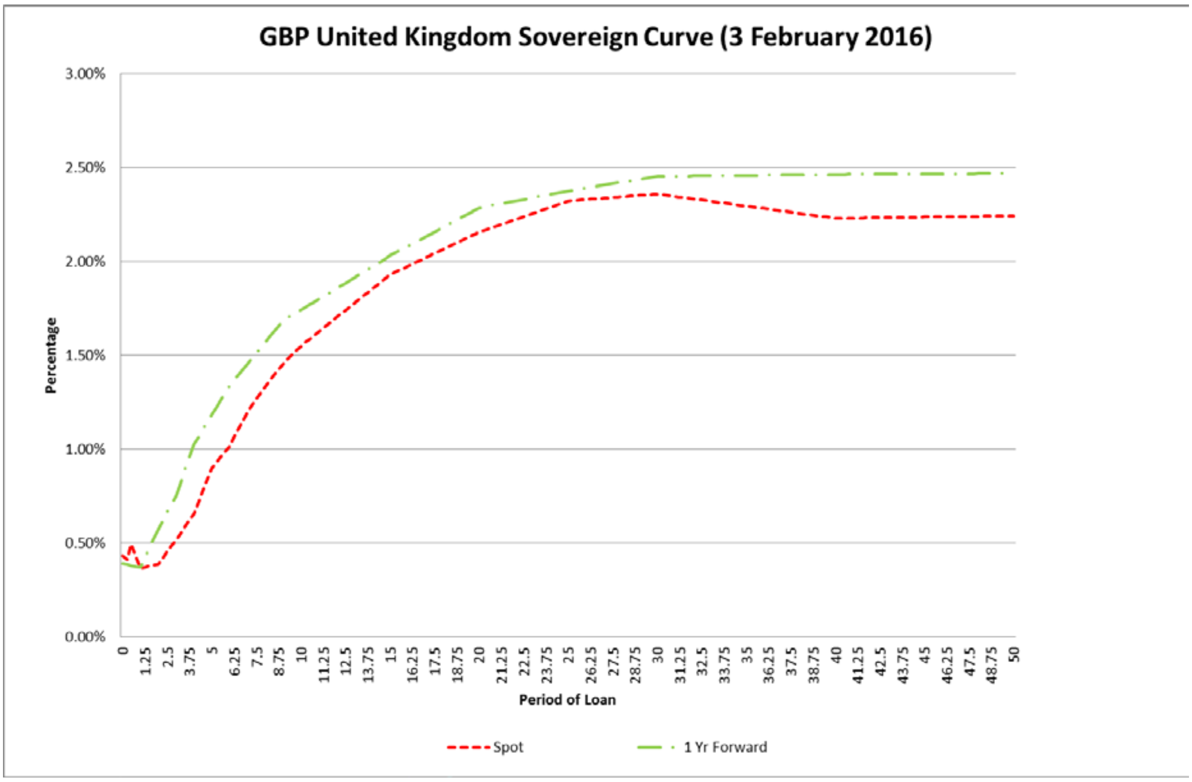
10. BORROWING STRATEGY

10.1. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

10.2. The factors that influence the 2016/17 strategy are the borrowing requirements, the current economic and market environments and the interest rate forecast.

10.3. Investment returns are likely to remain relatively low during 2015/16 and beyond. Borrowing interest rates have been 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. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years and this will be kept under review.

10.4. 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. The graph on page 18 shows the current Gilt rates and those projected (by investors) in a year's time. It is apparent, an increase in interest rates across all maturities is expected – though a limited increase rather than a material change. It should be noted that this has been the case for the last 3 or 4 years.



Source: Bloomberg as at 3 February 2016

10.5. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR), 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.

10.6. Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Treasury Management team monitors interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

10.7. If it were considered that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered. Consideration will also be given to the maturity profile of the debt portfolio so the Council is not exposed to the consideration of debt being repaid or renewed in any one year. The table below sets the limits on maturity profile and also provides the summarised position as at December 2015 for which the detail is provided in the chart at 10.7.

PIs 8 Limits on borrowing activity and PI 10 Surplus funds invested

10.8. The Prudential Code requires the Council to set three debt/borrowing related PIs to provide limits to the activity of the Treasury function. The aim of this is to manage risk and reduce the impact of any adverse movement in interest rates, on the one hand but at the same time not setting the limits to be too restrictive that they impair opportunities to reduce costs or improve performance.

10.9. The PIs are:

(i) Upper limits on variable interest rate exposure. This is the maximum borrowing permitted for variable rates based on the debt position net of investments

(ii) Upper limits on fixed interest rate exposure. This is similar to the above but for fixed rate borrowing.

(iii) Upper limits for surplus funds invested over 364 days.

10.10. During 2015/16 investment of surplus funds for more than 364 days totalled £35.8m which was well within the upper limit for such investments of £300m.

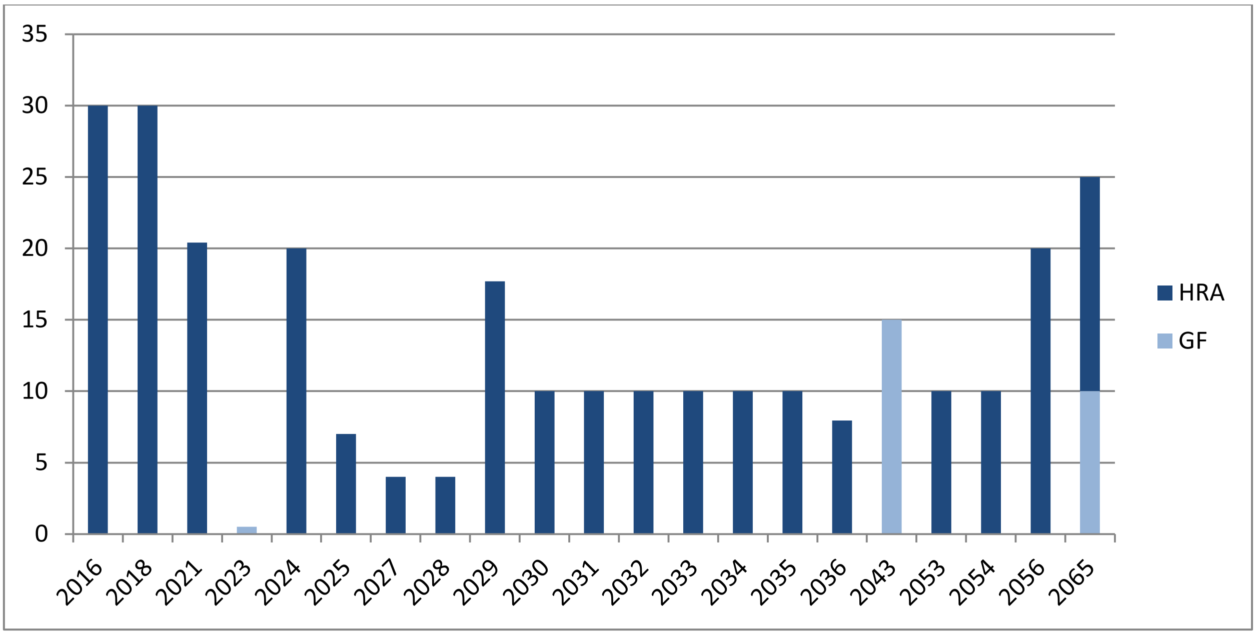
Table 10	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**
	Forecast	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Upper limit for fixed interest rate exposure						
Net principal re fixed rate borrowing	282	258	258	495	494	646
Upper limit for variable rate exposure						
Net principal re variable rate borrowing	0	0	0	0	0	0
Upper limit for principal sums invested over 364 days	300	200	100	100	100	100

10.11. **PI 9 Maturity structure of borrowing**. This PI aims to reduce the Council's exposure to large fixed rate sums falling due for re-financing in a short period of time. Table 11 below sets the limits on maturity profile and also provides the summarised position as at December 2015 for which the detail is provided in the chart at 10.13.

Table 11	**upper limit**	**lower limit**	**As at 31 December 15**
Maturity structure of borrowing	**%**	**%**	**%**
under 12 months	40	0	11
12 months and within 24 months	35	0	0
24 months and within 5 years	35	0	11
5 years and within 10 years	50	0	16
10 years and above	100	35	62

10.12. In the event that there is a much sharp rise in long and short term rates than currently forecast, then the balance of the loan portfolio will be re-visited with a view to taking on longer term fixed rate borrowing in anticipation of future rate rises.

10.13. The chart below shows the principal repayment profile for the Council's current borrowings. Based on current interest rates and capital financing requirements the loans maturing in 2016 and 2018 will need to be considered for repayment or refinancing.



10.14. The Council has £70 million of LOBO (Lender Option Borrower Option) debt, none of which has final maturity in the near future. Were the lender to exercise their option, Officers will consider accepting the new rate of interest or repaying (with no penalty). Repayment of the LOBO may then require re-financing at the prevailing market rates.

10.15. Members will recall that, from 2017/18, Service Areas will be charged in full for the revenue consequences incurred from borrowing to fund their capital expenditure. This will ensure that the cost of spending decisions are taken into account when considering all programmes of work and will make sure the programme is fully financed on an on-going basis.

10.16. **Policy on Borrowing in Advance of Need**

(i) Under Local Authorities (Capital Finance and Accounting)(England) Regulations 2008, the Council can borrow in advance of need in line with its future borrowing requirements.

(ii) 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.

(iii) Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

10.17. **Debt Rescheduling**

(i) 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).

(ii) 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; and
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

(iii) Consideration will also be given to identifying 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.

(iv) Any rescheduling will be reported to Housing, Finance & Customer Services Policy and Scrutiny Committee, in accordance with the usual monitoring cycle.

11. ANNUAL INVESTMENT STRATEGY

Investment Policy

11.1. The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Investment 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.

11.2. In accordance with the above guidance the Council's objective when investing money is to strike an appropriate balance between risk and return by minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

11.3. The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a rating 'uplift' due to implied levels of sovereign support. Commencing in 2015, in response to the evolving bank bail-in regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into rating through the financial crisis.

11.4. The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. 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 all three ratings agencies.

11.5. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually 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.

11.6. The aim of the strategy is to generate a list of highly creditworthy counterparties which will provide security of investments, enable divesification and minimise risk.

11.7. Investment instruments identified for current use are listed in 11.12 below. Counterparty limits will be as set through the Council's treasury management practices and are included in Appendix 1.

Creditworthiness Policy

11.8. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

11.9. The City Treasurer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

11.10. The Council takes into account the following relevant matters when proposing counterparties:
(i) the market pricing of Credit Default Swaps[2] for the institution;
(ii) any implicit or explicit Government support for the institution;
(iii) Standard & Poor's, Moody's and Fitch's short and long term credit ratings; and
(iv) Sovereign ratings to select counterparties from only the most creditworthy countries.

11.11. Changes to the credit rating will be monitored and in the event that a counter party is downgraded and does not meet the minimum criteria specified in Appendix 1, the following action will be taken immediately:
(i) no new investments will be made;
(ii) existing investments will be recalled if there are no penalties; and
(iii) full consideration will be given to recall or sale existing investments which would be liable to penalty clause.

[2] Credit Default Swaps (CDS) are tradable instruments where the buyer receives a pay-out from the seller if the party to whom the CDS refers (often a financial institution) has a "credit event" (e.g. default, bankruptcy, etc.). The price of the CDS gives an indication to the market's view of likelihood – the higher the price the more likely the credit event.

Current Investment Types

11.12. As per the 2015/16 Treasury Management Strategy, it is proposed that for 2016/17 the Council can continue to invest in financial institutions, external funds and certain capital market instruments as set out below. All investments would be in Sterling.

(i) investment with the Debt Management Office (UK Government guaranteed);
(ii) investment in financial institutions of a minimum credit rating, with the parent company domiciled only in jurisdictions as per paragraphs 11.16-11.18 below, covering call/notice accounts, deposits and certificate of deposit;
(iii) investment in UK Treasury Bills (T-Bills) and Gilts (conventional and indexed-linked) both fixed and floating rate;
(iv) investments in UK Government repurchase agreements ("Repos" and "Reverse Repos");
(v) investments in UK local authorities;
(vi) investment in close to maturity AAA-rated corporate bonds and commercial paper backed by UK Government guarantees (fixed and floating rate);
(vii) investment in supra-national AAA-rated issuer bonds and commercial paper (fixed and floating rate);
(viii) investment in AAA-rated Sterling Money Market Funds and longer term funds;
(ix) investment in commercial paper ("CP") of UK domiciled entities with minimum short term credit rating of A-1/P-1/F-1;
(x) Commercial Paper issued by European companies with minimum short term credit rating of A-1/P-1/F1 domiciled in countries set out in paragraphs 11.16 - 11.18 below; and
(xi) Covered Bonds. These are debt instruments issued by a financial institution where security has been granted over a pool of underlying assets to which investors have a preferential claim in the event of default, with a minimum long term rating of AA+/Aa1/AA+.

11.13. In addition to the above, it is proposed to add Collateralised Deposits whereby the deposit is secured against Local Authority Loans, including loans issued by the authority itself. This has been incorporated in the investment schedule at Appendix 1.

Specified and Non-specified investments

11.14. Under section 15(1) of the Local Government Act 2003, restrictions are placed on Local Authorities around the use of specified and non-specified investments. A specified investment is defined as an investment which satisfies all of the conditions below:

(i) The investment and any associated cash flows are denominated in sterling;
(ii) The investment has a maximum maturity of one year;
(iii) The investment is not defined as capital expenditure; and
(iv) The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

11.15. A non-specified investment is any investment that does not meet all the conditions above. The only likely non-specified investment that the Council may make is for any investment greater than one year as set out in Appendix 1. For such an investment, a proposal will be made by the Director of Treasury and Pensions, to the s151 Officer after taking into account cash flow requirements, the outlook for short to medium term interest rates and the proposed investment counterparty.

Country of Domicile

11.16. The current TMS allows deposits / investments with financial entities domiciled in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK and USA. This list will remain for 2016/17, however in the light of the evolving regulatory environment mentioned in 11.4 above, this list will be kept under review and any changes to the policy will be reported to the next meeting.

11.17. For Commercial Paper and bonds issued by supra-nationals and European agencies, the entities must be domiciled in countries listed above.

11.18. For Commercial Paper for UK and European corporates, the entities must be domiciled in the EU countries named in paragraph 11.16 above.

Investment Strategy

11.19. The Council holds significant invested funds, representing income received in advance of expenditure, balances and reserves. During the current year, the Council’s average investment balance has been around £850m and this pattern is expected to continue in the forthcoming year. Investments are 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).

11.20. **Investment returns expectations.** Bank Rate has remained unchanged at 0.50% since March 2009 and is not forecast to rise until quarter 4 of 2016.

11.21. **Investment treasury limit** - This limit is set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment. For the year 2016/17, the proposed limit of investments for over 364 days is £200m.

11.22. The Treasury and Pensions service is investigating a number of options to increase budgeted income generated from the Council’s cash balances. The options as currently being considered are in line with this draft Treasury Management Strategy to be tabled for Council approval in March 2016 following the addition of Collateralised Deposits to the Investment Schedule in Appendix 1.

12. BACKGROUND AND FINANCIAL AND LEGAL IMPLICATIONS

12.1. The Local Government Act 2003 requires the Council to ‘have regard to’ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. These are contained within this report.

12.2. The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments. The Annual Investment Strategy must have regard to guidance issued by CLG and must be agreed by the full Council.

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

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13. BACKGROUND PAPERS

Treasury Management Strategy 2015/16 (Approved by Council March 2015)

1. Revised CIPFA Treasury Management Code of Practice 2011
2. CIPFA Prudential Code
3. Local Authorities (Capital Finance and Accounting) (England) Regulation 2003, as amended
4. Section 3 Local Government Act 2003
5. CLG Guidance on Local Government Investments – March 2010

Appendix 1

Maximum Amounts and Tenors of Investments

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment
DMO Deposits	UK Government Rating	Unlimited	6 months
UK Government (Gilts / T-Bills / Repos)	UK Government Rating	Unlimited	Unlimited
Supra–national Banks	AA+ / Aa1 / AA+	£200m	5 years
European Agencies	AA+ / Aa1 / AA+	£200m	5 years
Network Rail	UK Government Rating	Unlimited	Oct 2052
TfL	AA-/Aa3/AA-	£100m	5 years
GLA	NA	£100m	5 years
UK Local Authorities	NA	£50m per Local Authority, £100m in aggregate	3 years
GBP denominated Commercial Paper issued by UK and European[3] corporates	A-1 / P-1 / F-1	£40m per name, £200m in aggregate	Six months
Money Market Funds MMF	AAA / Aaa / AAA be AAA by at least two of the main credit agencies	£70m per fund manager, £300m in aggregate	Three day notice
Enhanced Money Funds	AAA / Aaa / AAA by at least one of the main credit agencies	£25m per fund manager, £75m in aggregate	Up to seven day notice
Covered Bonds	AA+ / Aa1 / AA+ Minimum rating of the underlying securities or the Bond itself	£300m	10 years
Collateralised Deposits	Collateralised against Local Authority Loans	£60m	50 years
UK Bank (deposit or Certificates of Deposit)	AA- / Aa3 / AA- and above (or UK Government ownership of greater than 25%), subject to minimum ST ratings	£75m	5 years
UK Bank (deposit or Certificates of Deposit)	A- / A3 / A- and above, subject to minimum ST ratings	£50m	3 years
Non-UK Bank (deposit or Certificates of Deposit)	AA- / Aa2 / AA- and above, subject to minimum ST ratings	£50m	5 years
Non-UK Bank (deposit or Certificates of Deposit)	A / A2 / A and above, subject to minimum ST ratings	£35m	3 years

[3] Subject to paragraph 11.16

Appendix 2

Treasury Management Delegations and Responsibilities

The respective roles of the Council, Cabinet, Housing Finance & Customer Services Policy and Scrutiny committee and Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

<u>Council</u>

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

<u>Cabinet</u>

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

<u>Housing Finance & Customer Services Policy and Scrutiny Committee</u>

This committee is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

<u>Section 151 Officer</u>

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. The s151 Officer has full delegated powers from the Council and is responsible for the following activities:

(i) Investment management arrangements and strategy;
(ii) Borrowing and debt strategy;
(iii) Monitoring investment activity and performance;
(iv) Overseeing administrative activities;
(v) Ensuring compliance with relevant laws and regulations;
(vi) Provision of guidance to officers and members in exercising delegated powers.

<u>Director of Treasury and Pension Fund</u>

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

<u>Treasury Team</u>

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures.