MANAGEMENT STRATEGY 2014/15

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. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the investment reduction 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.

CIPFA defines treasury management as:

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

1.2 Reporting requirements

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

Prudential and treasury indicators and treasury strategy (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.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit & Scrutiny Committee.

1.3 Treasury Management Strategy for 2014/15

The strategy for 2014/15 covers two main areas:

Capital issues
- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

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.

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

1.4 Training

The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Capita (formerly Sector), as its external treasury management advisors.

The Council 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.

It also 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.

2. THE CAPITAL PRUDENTIAL INDICATORS 2014/15 – 2016/17

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts. It also summarises how these plans are being financed by capital or revenue resources. Any shortfall of resources will result in the need to use additional capital resources or ultimately create a borrowing requirement.

Capital Expenditure					
	2012/13 £000 Actual	2013/14 £000 Revised	2014/15 £000 Estimate	2015/16 £000 Estimate	2016/17 £000 Estimate
Proposed Capital programme:					
Capital expenditure	3,772	5,242	4,492	1,582	1,492
c/f capital schemes		(2,498)	2,498		
	3,772	2,744	6,990	1,582	1,492
Financed by:					
Capital receipts	3,172	1,834	5,898	910	820
Capital Grants	600	410	522	422	422
General Fund	0	0	570	250	250
Earmarked reserves	0	500	0	0	0
	3,772	2,744	6,990	1,582	1,492

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

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from amounts held in the balance sheet relating capital expenditure and the associated sources of financing. This includes certain assets which may have been acquired under finance-lease or PFI-type arrangements, where the Council accounts for the asset on its balance sheet, but the asset is not fully financed.

The Council can borrow without limit, provided it ensures such borrowing is affordable, prudent and sustainable.

Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual capital financing requirement at 31st March 2012 are:

Capital Financing Requirement (CFR)					
	31/3/13 £000 Actual	31/3/14 £000 Revised	31/3/15 £000 Estimate	31/3/16 £000 Estimate	31/3/17 £000 Estimate
Total CFR	0	0	0	0	0

2.3 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:

2.4 Ratio of financing costs to net revenue stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. As the Council is in a net investment position (investment income is greater than interest payable) the calculation results in a negative figure.

Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2012/13 are:

Ratio of Financing Costs to Net Revenue Stream					
	2012/13 Actual %	2013/14 Revised %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
Ratio	-2.99	-1.88	-1.94	-1.97	-1.99

2.5 Incremental impact of capital investment decisions on council tax

A fundamental indicator of the affordability of capital expenditure plans is its impact on council tax. Any borrowing for capital purposes has an impact on the revenue account and, to the extent that it is not supported by government or other contributions, on council tax. The capital programme is primarily funded through the use of the Council's capital receipt balances. Using capital receipts has the effect of reducing the ability to raise investment income on the balances, and thus impacts upon the revenue budget.

As the Council is currently debt-free, the increase in cost equates to the loss in investment interest the Council no longer generates as its capital reserves are consumed. Based upon the proposed Capital Programme in point 2.1 above (including schemes carried-forward into 2014/15), if the cost in lost investment income receipts were borne by the taxpayer, at the bank of England base-rate estimates used in the MTFP, the cost per taxpayer in lost investment income receipts would be as follows:

	2014/15 £	2015/16 £	2016/17 £
Cost per 'band D' taxpayer:	0.88	0.16	0.21

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. The strategy covers the relevant treasury / prudential indicators, any projected or current debt positions (if any) and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2013, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£000	2012/13 Actual	2013/14 Revised	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
External Debt					
Debt at 1 April	0	0	0	0	0
Expected change	0	0	0	0	0
in Debt	0	0	0	0	0
Actual debt at 31	**0**	**0**	**0**	**0**	**0**

March					
Capital Financing Requirement	0	0	0	0	0
Under / (over) borrowing	0	0	0	0	0

Estimated investments at 31 March					
Investments	15,000	15,000	15,000	15,000	15,000
Investment change	0	0	0	0	0

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, 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 2014/15 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

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

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. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary for External Debt				
	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000
Borrowing	4,500	4,500	4,500	4,500
Other long term liabilities	0	0	0	0
Total	4,850	4,500	4,500	4,500

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

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The Council is asked to approve the following authorised limit:

Authorised Limit for External Debt				
	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000
Borrowing	6,500	6,500	6,500	6,500
Other long term liabilities	0	0	0	0
Total	6,500	6,500	6,500	6,500

3.3 Prospects for interest rates

The Council has appointed Capita (formerly Sector) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
March 2014	0.50	2.50	4.40	4.50
June 2014	0.50	2.60	4.40	4.40
Sept 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.50	4.60
March 2015	0.50	2.80	4.60	4.70
June 2015	0.50	2.80	4.70	4.80
Sept 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
March 2016	0.50	3.20	5.00	5.10
June 2016	0.50	3.30	5.10	5.20
Sept 2016	0.75	3.50	5.10	5.20
Dec 2016	1.00	3.60	5.10	5.20
March 2017	1.25	3.70	5.20	5.30

Until 2013, the economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history. However, growth rebounded in quarter 1 and 2 of 2013 to surpass all expectations. Growth prospects remain strong looking forward, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have amended this to some extent.

A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

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

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of government debt, in some countries, continue to rise to levels that compound already existing concerns. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2014/15 and beyond;
- Borrowing interest rates have risen significantly during 2013 and are on a rising trend.

3.4 Borrowing strategy

The Council is currently debt free and is not looking to take on any debt in the near future. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still relatively high.

The Chief Finance Officer will monitor interest rates in the financial markets and adopt a pragmatic approach to any changing circumstances.

3.5 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.

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.

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated 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 with a full understanding of what these reflect in the eyes of each agency. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, 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 continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector, 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.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

4.2 Specified and Non- Specified Investments

Specified Investments are investments offering high security and high liquidity. The investments will be sterling denominated with maturities up to a revised maximum of one year and meet the minimum 'high' credit rating criteria where applicable. Instruments identified for use in the financial year are listed in table below under the 'specified' and 'non-specified' investments categories.

SPECIFIED INVESTMENTS
All 'Specified and Non Spcified Investments' listed below must be sterling-denominated.

The types of investments that will be used by the Council

Investment	Max Sum per institution/group	Maximum period
Debt Management Agency Deposit Facility* (DMADF) • this facility is at present available for investments up to 6 months	UNLIMITED	6 months
UK Government Gilts	£2m	2 years
UK Government Treasury Bills	UNLIMITED	1 year
Corporate Bond Funds	£2m	10 years
Term deposits with the UK government or with UK local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 1 year	£7m	1 year
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 1 year (UK & Non-UK)	£7m	1 year
Money Market Funds with UK/Ireland/Luxembourg domiciled	£1m	1 year
Corporate Bonds held in a broker's nominee account (King & Shaxson Ltd)	£2m	10 years
T-Bills issued by the DMO (Government)	UNLIMITED	1 year
Certificates of deposit (CD's) issued by banks and building societies covered by UK Government (explicit) guarantee	£7m	2 years

Non-specified investments are of greater potential risk and cover deposit periods over one year. Capita continue to maintain the view that, for the time being, clients should look to the short end of the market when making investment decisions and it is the intention of this Council to lend for a maximum period of two years as recommended by Capita.

4.3 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita (formerly Sector). This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No colour not to be used

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

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A, viability rating of A, and a support rating of 1 for UK banks and a minimum rating of AA- for non-UK banks. Appendices B and C show the current list in use at the time of this report.There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly and upon any adhoc changes. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

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

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

4.4 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of **AAA** from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix C. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back,there could be downside risk, particularly if Bank of England inflation forecasts for the rate of unemployment were to prove to be too optomistic.

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

2014/15	0.50%
2015/16	0.50%
2016/17	0.75%
2017/18	2.25%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts and money market funds in order to benefit from the compounding of interest.

4.5 Council's Banker

The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A (or equivalent) long term. It is the Councils intention that even if the credit rating of LloydsTSB falls below the minimum criteria A the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

4.6 Annual Minimum Revenue Provision (MRP) Statement

The annual MRP Statement is disclosed in Appendix D.

4.7 Balanced Budget Requirement

The Authority complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

4.8 Reporting on the Treasury Outturn

The Head of Finance and Audit/Head of GO Shared Services, (Designated Section 151 Officer) will report to Council on its treasury management activities and performance against the strategy at least twice a year, one at mid year and a year end review at closedown time.

The Audit & Scrutiny Committee will be responsible for the scrutiny of treasury management activity and practices.

4.9 Other Items

4.10 Training

In CIPFA's Code for Treasury Management, it requires the Head of Finance and Audit/Head of GO Shared Services (Designated Section 151 Officer) to ensure that all appropriate staff and members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Training requirements will be identified and any shortfalls will be met by Sector or other organisations.

4.11 Treasury Advisors

The CLG's Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external advisors offering information, advice or assistance relating to investment and
- How the quality of any such service is controlled.

The Council appointed Capita Asset Services Ltd (formerly known as Sector) as its external advisor in December 2012. They provide the Council with information, advice and assistance in all areas of treasury. The Council aims to have a close working relationship with Capita and will be in contact with their advisors on a regular basis (weekly) and daily if necessary. A detailed schedule of services is listed within the contract. The Council recognises that responsibility for treasury management decisions remains with the Council at all times.