Appendix 'A'

TREASURY MANAGEMENT STRATEGY 2016/17

1. INTRODUCTION

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 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."*

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 Committee.

Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues

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

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. This Council has addressed this important issue by providing training sessions for the Audit Committee members on the subject of treasury management and will carry on doing so.

Treasury management consultants

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors and recently extended the contract to December 2018.

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 2016/17 – 2018/19

The Council's capital expenditure plans are a key driver in 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					
	2014/15 £000 Actual	2015/16 £000 Budget**	2016/17 £000 Estimate	2017/18 £000 Estimate	2018/19 £000 Estimate
Proposed Capital programme:					
Capital expenditure	1,399	8,266	2,150	2,061	1,434
c/f capital schemes*		(1,492)	1,492		
	1,399	6,774	3,642	2,061	1,434
Financed by:					
Capital receipts	488	5,872	2,820	1,411	784
Capital Grants	661	422	422	400	400
General Fund	250	250	250	250	250
Earmarked reserves	0	230	150	0	0
	1,399	6,774	3,642	2,061	1,434

* This represents an estimate of the schemes planned for 2015/16 that will be incomplete at 31st March 2016 and the budget will therefore be carried-forward into 2016/17.

** The 2015/16 budget shown is the approved budget, less the estimate for budgets to carry-forward into 2016/17.

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR represents the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing need. Any capital expenditure that has not immediately been paid for will increase the CFR.

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, 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 2015 are:

Capital Financing Requirement (CFR)					
	31/3/15 £000 Actual	31/3/16 £000 Revised	31/3/17 £000 Estimate	31/3/18 £000 Estimate	31/3/19 £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 actual ratio of financing costs to net revenue stream for 2014/15 and estimates for the current and future years are:

Ratio of Financing Costs to Net Revenue Stream					
	2014/15 Actual %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Ratio	-2.46	-2.10	-2.55	-2.59	-2.57

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 2016/17), if the cost in lost investment income receipts were borne by the taxpayer, at the bank of England base-rate estimates quoted in this report, the cost per taxpayer in lost investment income receipts would be as follows:

	2016/17 £	2017/18 £	2018/19 £
Cost per 'band D' taxpayer in £:	0.66	0.64	0.46

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 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 2015, 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	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External Debt:					
Debt at 1 April	0	0	0	0	0
Expected change in Debt	0	0	0	0	0
Actual debt at 31 March	**0**	**0**	**0**	**0**	**0**

£000	2014/15 Actual	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
The Capital Financing Requirement	0	0	0	0	0
Under / (over) borrowing	0	0	0	0	0
Investments	**20,893**	**23,000**	**23,000**	**22,000**	**21,000**

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 2016/17 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.

Operational Boundary for External Debt				
	2015/16 £000	2016/17 £000	2017/18 £000	2018/19 £000
Borrowing	4,500	4,500	4,500	4,500
Other long term liabilities	0	0	0	0
Total	4,500	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				
	2015/16 £000	2016/17 £000	2017/18 £000	2018/19 £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 Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2015	0.50	2.30	3.60	3.50
March 2016	0.50	2.40	3.70	3.60
June 2016	0.75	2.60	3.80	3.70
Sept 2016	0.75	2.70	3.90	3.80
Dec 2016	1.00	2.80	4.00	3.90
March 2017	1.00	2.80	4.10	4.00
June 2017	1.25	2.90	4.10	4.00
Sept 2017	1.50	3.00	4.20	4.10
Dec 2017	1.50	3.20	4.30	4.20
March 2018	1.75	3.30	4.30	4.20
June 2018	1.75	3.40	4.40	4.30
Sept 2018	2.00	3.50	4.40	4.30
Dec 2018	2.00	3.50	4.40	4.30
March 2019	2.00	3.60	4.50	4.40

Until 2013, the economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 and especially during 2014, to surpass all expectations. The November 2015 Bank of England Inflation Report included a forecast for growth to remain around 2.5-2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

In the Eurozone, the ECB used its powers in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is 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 rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, 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%.

The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 1.5% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now firmly opened up the possibility of a first rate rise in December.

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 been funded from the Council's reserves and balances. 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 applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; 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.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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

Investment instruments identified for use in the financial year are listed in Annex B under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied soverign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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

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

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.

Investment instruments identified for use in the financial year are listed below in paragraph 4.2 under the 'specified' and 'non-specified' investments categories as well as the counterparty limits.

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.

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 for fixed term deposits.

Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	×
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	×
Commercial Paper	✓	×
Corporate Bonds	✓	✓
AAA rated Money Market Funds	✓	×
Property Funds	✓	✓
Other Money Market and Collective Investment Schemes (including Property Funds)	✓	✓
Debt Management Account Deposit Facility	✓	×

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

	* Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF - UK Government	N/A	£unlimited	6 months
UK Government gilts	UK sovereign rating	£2m	2 years
UK Government Treasury bils	UK sovereign rating	£2m	2 years
Bonds issued by multilateral development banks	UK sovereign rating	£2m	6 months
Money market funds	AAA	£5m per fund	Liquid
Local authorities	N/A	£5m	2 years
Enhance Money Market funds	AAA	£5m per fund	Liquid
Pooled Funds	UK sovereign rating AAA	£4m per fund	2 Years
Term deposits with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£9m per banking group but £7m per bank/building Society	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
CDs or corporate bonds with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£9m per banking group or £7m per bank/building society	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
Corporate bond funds	UK sovereign rating	£4m in total	Up to 10 Years
Gilt funds	UK sovereign rating	£2m in total	Up to 5 Years
Property funds	UK sovereign rating	£5*m in total	Non-Specified

**increased from £2m to reflect balances held from disposal of surplus land assets which are available for investment over a longer period*

4.3 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. 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-. The table shown in appendix B shows 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 avaialble, or other topical market information, to support their use. UK part nationalised banks such as National Westminster Bank and Royal Bank of Scotland are currently rated as BBB+ but remain on the list as they have the government support at present. However, once the majority of these banks shares are sold they will be colour coded as an unsupported bank in line with all the other banks, and if the rating falls below A-, will be removed from the lending list.

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 any external support for banks to help support its decision making process.

4.4 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of **AA+ (moved down from AAA 2015/16)** from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix B. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Approved countries for investments

AA+ or higher

- Australia
- Canada
- Denmark
- Finland
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland
- U.S.A

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2/3 of 2016.

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 Lloyds 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 C.

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.

(END)