Cambridgeshire County Council

Treasury Management Strategy Statement

Treasury Management Strategy Statement

Contents

1. Introduction

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management requires the preparation of an annual Treasury Management Strategy Statement (TMSS). The 2003 Prudential Code for Capital Finance in Local Authorities introduced new requirements on how capital spending plans should be considered and approved and the development of an integrated treasury management strategy.

1.2 The CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to set the Treasury Management Strategy Statement (TMSS) for borrowing each financial year.

1.3 CIPFA has defined Treasury Management 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 This strategy takes into account the impact of the Council's Revenue Budget, Medium Term Capital Programme and the Balance Sheet position. The Prudential Indicators and the outlook for interest rates are also considered within the strategy.

1.5 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. The Treasury Management Scheme of Delegation is shown in Appendix 1.

1.6 Treasury management risks are identified in the Council's approved Treasury Management Practices; the main risks to the Council's treasury activities are

- liquidity risk (inadequate cash resources)
- market or interest rate risk (fluctuations in interest rate levels and thereby in the value of investments)
- inflation risks (exposure to inflation)
- credit and counterparty risk (security of investments)
- refinancing risks (impact of debt maturing in future years)
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud)

1.7 The Treasury Management Strategy for 2013-14 covers

- the current treasury position
- prospects for interest rates
- the borrowing strategy to finance the capital plans
- the prudential and treasury indicators
- the Minimum Revenue Provision (MRP) strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

1.8 The main changes from the strategy adopted in 2012-13 are

- updated interest rate forecasts
- revised Prudential Indicators

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

2. Current Treasury Management position

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

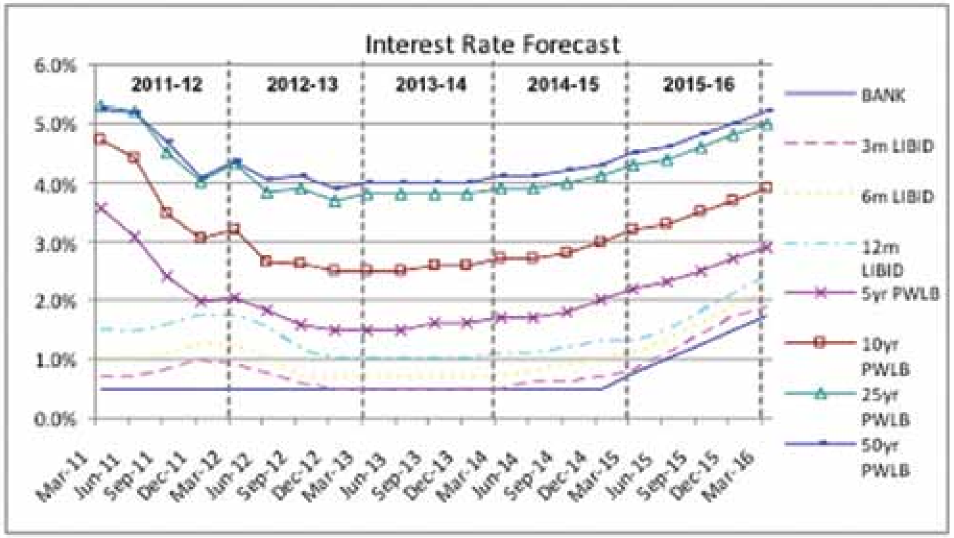
2.2 Within the set of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total borrowing, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current and next 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 except to cover short term cash flows.

2.3 The S151 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.

£m	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
External borrowing						
Borrowing at 1 April	378.3	391.1	462.1	462.1	500.1	500.1
Expected change in borrowing	12.8	71.0	0.0	38.0	0.0	0.0
Actual borrowing at 31 March	**391.1**	**462.1**	**462.1**	**500.1**	**500.1**	**500.1**
CFR – the borrowing need	**486.7**	**532.6**	**597.5**	**662.3**	**644.4**	**636.6**
Under/(over) borrowing	**95.5**	**70.5**	**135.3**	**162.2**	**144.3**	**136.5**
Investments	**32.9**	**57.0**	**41.5**	**17.3**	**37.7**	**46.0**
Total investments at 31 March						
Investment change	-13.5	24.1	-15.5	-24.2	20.5	8.3
Net borrowing	**358.3**	**405.1**	**420.7**	**482.8**	**462.4**	**454.1**

3. Prospects for interest rates

3.1 The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following graph gives the Sector central view for short term (Bank Rate) and longer fixed interest rates.



3.2 Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The impact of the Eurozone crisis on financial markets and the banking sector.
- The impact of the UK Government's austerity plan on confidence and growth.
- Monetary policy action failing to stimulate growth in western economies.
- The potential for weak growth or recession in the UK's main trading partners - the EU and US.

3.3 Growth in the UK economy is expected to be weak in the next two years. The Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter four of 2014. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market.

3.4 Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015-16; the consequent increase in gilt issuance is, therefore, expected to be reflected in an increase in gilt yields over this period. However, UK gilts are likely to retain safe haven status from Eurozone worries for some time. Eurozone politicians struggle to reach agreement on how to replace impressive sounding words with actually implementing an effective platform of measures to conclusively subdue the debt crisis. The longer run trend is therefore for gilt yields and Public Works Loan Board (PWLB) rates to rise, however near term quantitative easing is likely to keep yields depressed in the near term.

3.5 This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods.
- Investment returns are likely to remain low during 2013-14.
- Borrowing interest rates are currently attractive, and may remain low for some time. The timing of any borrowing will need to be monitored carefully.
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

4. Borrowing strategy

4.1 The Council is currently maintaining an under borrowed position. 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 quite high.

4.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2012-13 treasury operations. The S151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

4.3 Given that projections over the next five years show an increasing CFR and Bank Rate is expected to remain low, the Council will continue to use a mix of its own cash balances and long term borrowing to finance further capital expenditure. This strategy maximises short term savings.

4.4 However, the decision to maintain internal borrowing to generate short term savings will be evaluated against the potential for incurring additional long term borrowing costs in later years, when long term interest rates are forecast to be significantly higher.

Prudential & Treasury Indicators

4.5 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008 with a fully revised version being published in 2009 to incorporate changes towards implementing International Financial Reporting Standards (IFRS).

4.6 A full set of Prudential Indicators and borrowing limits are shown in Appendix 2.

Policy on borrowing in advance of need

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

Borrowing in advance will be made within the following constraints:

Year	Max. Borrowing in advance	Notes
2013-14	100%	Borrowing in advance will be limited to no more than the expected increase in borrowing need (CFR) over the period of the approved Medium Term Capital Programme, a maximum of 4 years in advance.
2014-15	50%	
2015-16	25%	
2016-17	10%	
2017-18	5%	

4.8 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the reporting mechanism.

Debt rescheduling

4.9 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).

4.10 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.
- Enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

4.11 Consideration will also be given to identify whether 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.

4.12 All rescheduling will be reported to the Cabinet, at the next quarterly report following its action.

5. Minimum Revenue Provision

5.1 The Council is required to repay an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

5.2 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the MRP Policy in Appendix 3.

5.3 The Council, in conjunction with its Treasury Management advisors, has considered the MRP policy to be prudent.

6. Investment strategy

6.1 Government Guidance on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set. The Guidance permits the Treasury Management Strategy Statement (TMSS) and the AIS to be combined into one document.

6.2 The Council's general policy objective is to invest its surplus funds prudently. Due to the ongoing uncertainty in the banking sector which has seen institutions fold, it is now felt more appropriate to focus on the safe return of the sum invested. As such the Council's investment priorities in priority order are

- the security of the invested capital
- the liquidity of the invested capital
- the yield received from the investment

6.3 A copy of the Council's Annual Investment Strategy is shown in Appendix 4.

7. Sensitivity of the forecast and risk analysis

7.1 The key risk sensitivities to this strategy are

- credit and counterparty risk
- liquidity risk
- interest rate risk
- refinancing risk
- legal and regulatory risk
- fraud, error and corruption risk
- market risk

7.2 Council officers, in conjunction with the treasury advisers, will monitor these risks closely. Particular focus will be applied to the following:

- The global economy – indicators and their impact on interest rates will be monitored closely. Investment and borrowing portfolios will be positioned according to changes in the global economic climate.
- Counterparty risk – the Council follows a robust creditworthiness methodology and continues to monitor counterparties and sovereign ratings closely, particularly within the Eurozone.

8. Reporting arrangements

8.1 In line with best practice full Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are:

a) Prudential and Treasury Indicators and Treasury Strategy (this report)

The first, and most important report covers the following:

- The capital plans (including prudential indicators).
- A Minimum Revenue Provision 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.
- An investment strategy (the parameters on how investments are to be managed).

b) A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and indicating whether the treasury strategy is meeting the strategy or whether any policies require revision.

c) 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.

In addition Cabinet will receive quarterly **Monitoring Reports.** The second and fourth quarter report will go to full Council as described above. The quarterly reports will be subject to the scrutiny function.

9. Treasury Management budget

Treasury Management budget table

	2013-14 £m	2014-15 £m	2015-16 £m	2016-17 £m	2017-18 £m
Interest Payable	17.640	19.091	19.945	20.644	20.679
Investment Return	-0.285	-0.284	-0.259	-0.741	-1.127
Minimum Revenue Provision	17.684	19.873	22.949	25.944	25.814
Other	0.264	0.238	1.343	1.630	1.492
Total	35.304	38.918	43.978	47.477	46.858

Assumptions behind the 2013-14 budget:

- Average rates achievable on investments will be 0.5%.
- New borrowing to fund the capital programme will be financed by short term borrowing or the Council's own cash balances.
- Replacement borrowing will be taken out on a like for like basis as it matures.
- The MRP charge is in line with the Council's MRP policy.
- 'Other' includes broker fees, interest paid to schools and any discounts or premiums in relation to rescheduled loans.

10. Policy on the use of external service providers

10.1 The Council uses Sector as its external treasury management advisors.

10.2 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.

10.3 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.

11. Future developments

11.1 Local Authorities are having to consider innovative strategies towards improving service provision to their communities. This approach to innovation also applies to councils' treasury management activities. The Government is introducing new statutory powers and policy change which will have an impact on treasury management approaches in the future. Examples of such changes are noted below:

Localism Act

11.2 A key element of the Act is the "General Power of Competence": "A local authority has power to do anything that individuals generally may do."

11.3 The Act opens up the possibility that a local authority can use derivatives but CIPFA say it's not their role to offer a view of their legality; this would be a matter for the council to establish. CIPFA emphasises that where their legality is confirmed, then there is a need for a framework for their use. Hence, CIPFA have set out high level principles on how the council should use them and made changes to the TM Code and guidance notes accordingly.

Tax Incremental Financing

11.4 In its recent White Paper "Local Growth: realising every place's potential" which was released in November 2010, the Government outlined its plans to give councils the tools to promote growth, including giving more freedom for local authorities to make use of additional revenues to drive forward economic growth in their areas.

11.5 To this aim they are looking to introduce new borrowing powers to enable authorities to carry out Tax Incremental Financing (TIF).

11.6 In determining the affordability of borrowing for capital purposes, local authorities take account of their current income streams and forecast future income. Currently this does not factor in the full benefit of growth in local business rate income. TIF will enable local authorities to borrow against a future additional uplift to their business rates base.

11.7 This will require new legislation and will be closely linked to another Government initiative concerning the localisation of business rates i.e. local retention of business rate income.

11.8 It will be important to manage the costs and risks of this borrowing alongside wider borrowing under the Prudential Code.

11.9 It is thought that the scheme will be introduced via a bid-based pilot scheme and Cambridgeshire County Council is currently identifying areas where it could potentially be involved in the pilot project.

11.10 Further information will be available via the Local Government Resource Review which is due to be announced shortly.

11.11 The Council will explore these new opportunities and assess their impact on the Treasury Management Strategy, particularly in terms of risk to the sustainability, prudence and affordability to the Council's finances.

12. Training

12.1 A key outcome of the recent investigations into Local Authority investments is the need to ensure that all relevant Treasury Management staff have the appropriate training and knowledge in relation to these activities. Sector run training events regularly which are attended by the LGSS Treasury Team. In addition, members of the team attend national forums and practitioner user groups.

12.2 Treasury Management training for committee members will be delivered as required to facilitate informed decision making and challenge processes.

13. List of appendices

Appendix 1: Treasury Management Scheme of Delegation and Role of Section 151 Officer

Appendix 2: Prudential and Treasury Indicators

Appendix 3: Minimum Revenue Provision (MRP) Policy Statement

Appendix 4: Annual Investment Strategy

Appendix 1

Treasury Management Scheme of Delegation and role of the Section 151 Officer

The Scheme of Delegation

Full Council

Approval of annual strategy and mid year update to the strategy.

Approval of the annual treasury management report.

Approval of the Treasury Management budget.

Cabinet

Approval of the Treasury Management quarterly update reports.

Approval of the Treasury Management outturn report.

Scrutiny Committee

Scrutiny of performance against the strategy.

The Treasury Management role of the Section 151 Officer

The S151 (responsible) officer:

- Recommends clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance.
- Submits regular treasury management policy reports.
- Submits budgets and budget variations.
- Receives and reviews management information reports.
- Reviews the performance of the treasury management function.
- Ensures the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- Ensures the adequacy of internal audit, and liaising with external audit.
- Recommends the appointment of external service providers.

Appendix 2

Prudential and Treasury Indicators

1. The Capital Prudential Indicators

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

1.2 **Capital expenditure.** This prudential indicator shows the Council's capital expenditure plans; both those agreed previously, and those forming part of this budget cycle. Capital expenditure excludes spend on Private Finance Initiatives (PFI) and leasing arrangements, which are now shown on the balance sheet.

1.3 The table below summarises the capital expenditure plan and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

1.4 **The Council's borrowing need (the Capital Financing Requirement).** The second prudential indicator is the Council's Capital Financing Requirement (CFR) which is shown in the first table on page 153. The CFR is the total historical 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 in the table below, which has not immediately been paid for, will increase the CFR.

1.5 Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The CFR outlined in the first table on page 153 is shown net of these liabilities.

Capital Expenditure £m	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
Capital Expenditure	**169.4**	**138.2**	**178.0**	**180.1**	**105.6**	**96.1**
Financed by:						
Capital receipts	12.9	4.7	3.9	3.4	27.4	12.7
Capital grants	97.7	36.5	36.2	33.5	33.5	33.5
Capital contributions	26.2	33.4	53.1	55.4	36.6	31.7
Revenue	-	-	-	-	-	-
Net financing need for the year	**32.7**	**63.6**	**84.7**	**87.8**	**8.0**	**18.1**

Capital Financing Requirement £m	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
Capital Financing Requirement						
Total CFR	**486.7**	**532.6**	**597.5**	**662.3**	**644.4**	**636.6**
Movement in CFR	**16.0**	**45.9**	**64.9**	**64.8**	**-17.9**	**-7.8**

Movement in CFR represented by						
Net financing need for the year (above)	32.7	63.6	84.7	87.8	8.0	18.1
Less Capital Receipts to repay borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Less MRP and other financing movements	16.8	17.7	19.9	22.9	25.9	25.8
Movement in CFR	**16.0**	**45.9**	**64.9**	**64.8**	**-17.9**	**-7.8**

1.6 **The operational boundary.** This is the limit beyond which external borrowing 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 borrowing.

Operational boundary £m	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
Total Borrowing	528.7	532.6	597.5	662.3	644.4	636.6

1.7 **The authorised limit for external borrowing.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing 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 £m	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
Total Borrowing	558.7	562.6	627.5	692.3	674.4	666.6

2. Treasury Management limits on activity

2.1 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs or improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments.

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates.

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The interest rate exposure is calculated a percentage of net debt. The formula is shown below.

Total fixed (or variable) rate exposure
Total borrowing - short term investments

£m	2013-14	2014-15	2015-16	2016-17	2017-18
Interest rate Exposures					
	Upper	**Upper**	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	130%	130%	130%	130%	130%
Limits on variable interest rates based on net debt	30%	30%	30%	30%	30%

Maturity Structure of borrowing 2013-14		
	Lower	**Upper**
Under 12 months	0%	80%
12 months to 2 years	0%	50%
2 years to 5 years	0%	50%
5 years to 10 years	0%	50%

2.2 **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:

2.3 **Actual and estimates of the ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.

%	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
	9.39%	9.55%	10.68%	12.23%	13.26%	13.15%

2.4 **Estimates of the incremental impact of capital investment decisions on Council Tax.** This indicator identifies the revenue costs associated with proposed changes to the four year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a four year period.

2.5 **Incremental impact of capital investment decisions on the band D Council Tax.**

£	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
Council Tax band D	£5.17	£13.88	£17.29	£23.85	£16.26	£-2.84

Appendix 3

Minimum Revenue Provision Policy Statement

1. Policy statement

1.1 The Council is required to repay an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required.

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

1.3 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1).

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year. From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3).

This option provides for a reduction in the borrowing need over approximately the asset’s life.

Appendix 4

Annual Investment Strategy

1. Investment policy

1.1 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, then return.

1.2 Investment instruments identified for use in the financial year are listed in section 8 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

2. Creditworthiness policy

2.1 This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies.
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings.
- Sovereign ratings to select counterparties from only the most creditworthy countries.

2.2 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 duration for investments. The Council will therefore use counterparties within the following durational bands provided they are domiciled in the UK or AAA countries only:

• 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

2.3 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.

2.4 All credit ratings will be monitored daily. 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 or 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 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.

2.5 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 government support.

3. Country limits

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

Australia	Finland	Netherlands	Sweden
Canada	Germany	Norway	Switzerland
Denmark	Luxembourg	Singapore	UK*

3.2 * The exception will be the UK. At the time of writing it is rated AAA but there is a chance that this rating will be downgraded over the next 12 months, the impact of which may be higher borrowing costs for the Council. The continuation of investing in UK financial institutions will be the only exception to the AAA rating rule.

4. Banking services

4.1 Barclays currently provide banking services for the Council. It is the Council's intention that even if the credit rating of the provider of banking services falls below the minimum criteria the bank will continue to be used for short term liquidity requirements.

5. Investment position and use of Council's resources

5.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances.

Year End Resources £m	2012-13 Projected	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate
Fund balances/reserves	55.2	55.8	59.6	62.5	65.4	65.7
Capital receipts	1.5	1.5	1.5	1.5	1.5	1.5
Provisions	7.5	7.5	7.5	7.5	7.5	7.5
Other	28.0	25.7	27.2	27.0	26.6	26.9
Total core funds	**92.2**	**90.5**	**95.8**	**98.5**	**101.0**	**101.6**
Working capital surplus	36.2	37.0	81.0	81.0	81.0	81.0
Under/(over) borrowing	95.5	70.5	135.3	162.2	144.3	136.5
Expected Investments	**32.9**	**57.0**	**41.5**	**17.3**	**37.7**	**46.0**

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

5.3 The Council is asked to approve the following treasury indicator and limit 'total principal funds invested for greater than 364 days'. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year end.

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

Maximum principal sums invested >364 days				
£m	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Principal sums invested >364 days	No more than 30% of total investments			

5.5 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, notice accounts, money market funds and short dated deposits (overnight to three months) in order to benefit from the compounding of interest.

6. Specified investments

6.1 An investment is a specified investment if all of the following apply:

- The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
- The investment is not a long term investment (i.e. up to 1 year).
- The making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended].
- The investment is made with a body or in an investment scheme of high credit quality (see below) or with one of the following public-sector bodies:
    - The United Kingdom Government.
    - A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland.
    - High credit quality is defined as a minimum credit rating as outlined in section 8.2 of this strategy.

7. Non-specified investments

7.1 Non-specified investments are defined as those not meeting 6.1 above.

7.2 Lending to third parties:

- The Council has the power to lend monies to third parties subject to a number of criteria. Any loans to or investments in third parties will be made under the Well Being powers of the Council conferred by section 2 of the Local Government Act 2000 or permitted under any other act.
- The Well Being power can be exercised for the benefit of some or all of the residents or visitors to a local authority's area. The power may also be used to benefit organisations and even an individual.
- Loans of this nature will be under exceptional circumstances and must be approved by Cabinet.
- The primary aims of the Investment Strategy, in order of priority, are the security of its capital, liquidity of its capital and to obtain a return on its capital commensurate with levels of security and liquidity. These aims are crucial in determining whether to proceed with a potential loan.
- Recipients of this type of investment are unlikely to be a financial institution and therefore unlikely to be subject to a credit rating as outlined in section 3. In order to ensure security of the Authority's capital, extensive financial due diligence must be completed prior to any loan or investment being agreed. The Authority will use specialist advisors to complete financial checks to ascertain the creditworthiness of the third party. Where deemed necessary additional guarantees will be sought. This will be via security against assets and/or through guarantees from a parent company.

8. The use of specified and non-specified investments

8.1 Investment instruments identified for use in the financial year are as follows:

- The tables below set out the types of investments that fall into each category and the limits placed on each of these. A detailed list of each investment type is available in the Treasury Management Practices guidance notes.
- All investments will be within the UK or AAA sovereign rated countries.

8.2 Criteria for specified investments:

Specified investments			
Investment	Minimum security/credit rating	Maximum amount	Maximum period
Debt Management Agency Deposit Facility (DMADF)	Government backed	No maximum	6 months
UK Treasury Bills	Government backed	No maximum	9 months
UK Local Authorities	Government backed high security	No maximum	1 year
Certificate of Deposit / Term Deposits (including callable deposits) All colours are as per Sector's matrix	Purple	£20m individual/group	1 year
	Blue	£20m individual/group	1 year
	Orange	£20m individual/group	1 year
	Red	£20m individual/group	6 months
	Green	£20m individual/group	3 months
	No colour	Not to be used	N/A
UK Government Gilts	Government backed	No maximum	1 year
Money Market Funds	AAA rated	£20m individual	Liquid
Bonds (multilateral development banks)	AAA	£20m	1 year

8.3 Criteria for non-specified investments:

Non-specified investments (maximum 50% of total investments)			
Investment	Minimum security/credit rating	Maximum amount	Maximum period
UK Government	Government backed	No maximum	5 years
UK Local Authorities	Government backed high security	No maximum	5 years
Certificate of Deposit / Term Deposits (including callable deposits) All colours are as per Sector's matrix	Yellow Purple	£20m individual/group	5 years 2 years
Property Funds Unit Trust	Considered on an individual basis	£20m	-
UK Government Gilts	Government backed	No maximum	5 years
Sovereign Issues	AAA or UK	£20m	5 years
Corporate Bonds Funds	Considered on an individual basis	£20m	-
UK Bonds	AAA / Government backed	£20m	5 years
Bonds (multilateral)	AAA / Government backed	£20m	5 years

8.4 The Council may enter into forward agreements up to 3 months in advance of the investment commencing. If forward deposits are to be made, the forward period plus the deal period should not exceed the limits above.

9. Investments defined as capital expenditure

9.1 The acquisition of share capital or loan capital in any corporate body is defined as capital expenditure under Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded from capital or revenue resources and will be classified as 'non-specified investments'.

9.2 Investments in "money market funds" which are collective investment schemes and bonds issued by "multilateral development banks" – both defined in SI 2004 No 534 – will not be treated as capital expenditure.

9.3 A loan or grant or financial assistance by this Council to another body for capital expenditure by that body will be treated as capital expenditure.

10. Provisions for credit related losses

10.1 If any of the Council's investments appears at risk of loss due to default (i.e. this is a credit related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

11. End of year investment report

11.1 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

12. Pension fund cash

12.1 The Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1 January 2010. The Council will not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority will comply with the requirements of SI 2009 No 393.