APPENDIX ‘A’

TREASURY MANAGEMENT POLICY AND STRATEGY 2016/17

East Sussex County Council

CONTENTS

1. INTRODUCTION

The Treasury Management Policy and Strategy is one of the Council's key financial strategy documents and sets out the Council's approach to the management of its treasury management activities.

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of treasury management is to ensure that cash flow is adequately planned with cash being available when it is needed. Surplus monies are invested in lower risk counterparties or instruments, commensurate with the Council's risk appetite, providing adequate liquidity and considering investment return.

Another part of the treasury management service is the funding of the Council's capital programme. The capital programme provides a guide to longer cash flow planning to ensure that the Council can meet its capital investment requirement.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

'the management of the 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'.

The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments.

This strategy is updated annually to reflect changes in circumstances that may affect the strategy.

2. CIPFA REQUIREMENTS

The Council has adopted the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management (Revised 2011).

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement stating the policies, objectives and approach to risk management of the Council's treasury management activities (Section 3).

- Creation and maintenance of suitable Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (Section 4).

- Receipt by Full Council of an annual Treasury Management Strategy Statement (Section 5) including the Annual Investment Strategy (Section 6) and the Minimum Revenue Provision Policy (Section 7) for the year ahead.

- Production of a mid-year review report and an annual report covering activities during the previous year (this Council also presents a quarterly monitoring report to Cabinet).

- Delegation by the Council of responsibilities for implementing and regular monitoring of its treasury management policies and practices and for the execution and administration of treasury management decisions (this Council delegates responsibility for implementation and monitoring treasury management to Cabinet and responsibility for the execution and administration of treasury management decisions to the Section 151 Officer. The role of the Section 151 Officer in treasury management is described in Section 8).

- Delegation by the Council of the role of scrutiny for treasury management strategy and policies to a specific named body (this Council delegates this responsibility to the Audit, Best Value and Community Services Scrutiny Committee).

3. TREASURY MANAGEMENT POLICY STATEMENT

The policies and objectives of the Council's treasury management activities are as follows:

1. This Council defines its treasury management activities as

'The management of the 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'.

2. This 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. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.

3. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance management techniques, within the context of effective risk management.

4. TREASURY MANAGEMENT PRACTICES

The Council has created and maintains the following Treasury Management Practices (TMPs). These TMPs set out the manner in which the Council will seek to achieve its policies and objectives and how it will manage and control these activities.

TMP 1: Risk Management

TMP 2: Performance Management

TMP 3: Decision making and analysis

TMP 4: Approved instruments, methods and techniques

TMP 5: Organisation, clarity and segregation of responsibilities and dealing arrangements

TMP 6: Reporting requirements and management information arrangements

TMP 7: Budgeting, accounting and audit arrangements

TMP 8: Cash and cash flow management

TMP 9: Money laundering

TMP 10: Training and qualifications

TMP 11: Use of external service providers

TMP 12: Corporate governance

The Treasury Management Practices are regularly updated and further details of these can be found within the Accounts and Pensions Team.

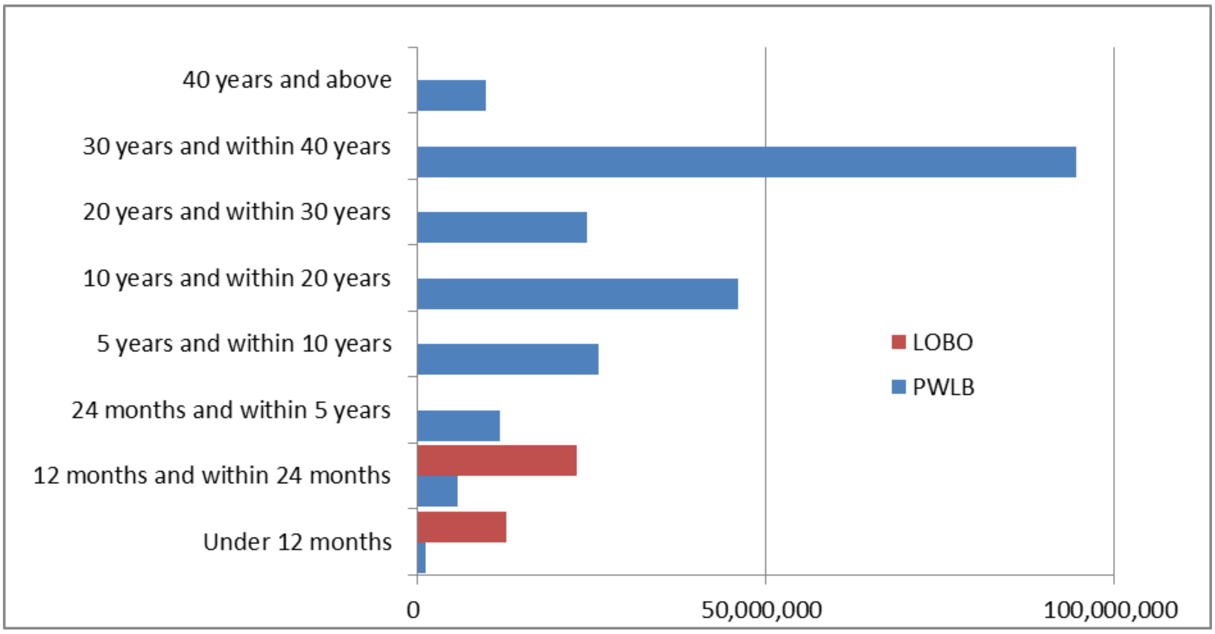
5. TREASURY MANAGEMENT STRATEGY STATEMENT

5.1 Current Investment & Borrowing Position

As at the 31 December 2015, the Council had £275 million of investments and the forecast for the year end is within the range of £280 to £300 million. The forecast average interest rate for the year is 0.75%, compared to the bank base rate of 0.50%. The investments will provide investment income of approximately £2.2 million in 2015/16.

The Council's long-term external borrowing (excluding PFI and finance lease arrangements) is projected to be £255m at 31 March 2016 with the majority sourced from the Public Works Loan Board (PWLB) at fixed interest rates of between 3.70% - 8.63%, with a weighted average rate of 5.20%. The PWLB allows local authorities to repay loans early and either pay a premium or obtain a discount according to a formula based on current interest rates.

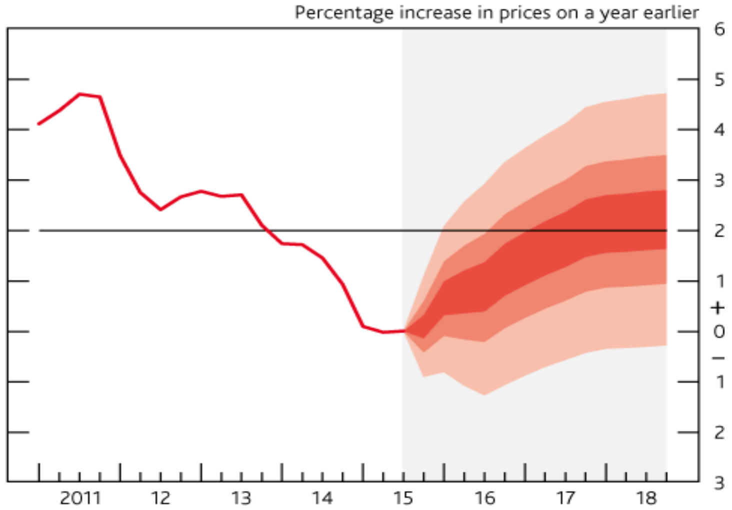
The Council's debt maturity profile as at 31 December 2015, showing the outstanding level of loans each year, is shown in **Graph 1** below:



5.2 Prospects for Interest Rates

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3.

The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years (see **Graph 2** below), 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 Council has appointed Capita Asset Services as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. **Table 1** below gives the Capita Asset Services central view for short term (Bank Rate) and longer fixed interest rates.

Table 1	**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
Mar 2016	0.50	2.40	3.70	3.60
Jun 2016	0.75	2.60	3.80	3.70
Sep 2016	0.75	2.70	3.90	3.80
Dec 2016	1.00	2.80	4.00	3.90
Mar 2017	1.00	2.80	4.10	4.00
Jun 2017	1.25	2.90	4.10	4.00
Sep 2017	1.50	3.00	4.20	4.10
Dec 2017	1.50	3.20	4.30	4.20
Mar 2018	1.75	3.30	4.30	4.20
Jun 2018	1.75	3.40	4.40	4.30
Sep 2018	2.00	3.50	4.40	4.30
Dec 2018	2.00	3.50	4.40	4.30
Mar 2019	2.00	3.60	4.50	4.40

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 Monetary Policy Committee (MPC) will decide to make a start on increasing Bank Rate.

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

- Investment returns are likely to remain relatively low during 2016/17 and beyond;

- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when the Council will not be able to avoid new borrowing to fund capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any new borrowing unless immediately spent as it will cause an increase in investments and this will incur a revenue loss between borrowing costs and investment returns as well as increased counterparty risks.

5.3 Borrowing Strategy

Capital Investment can be paid for using cash from one or more of the following sources:

i. Cash from existing and/or new capital resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves);
ii. Cash raised by borrowing externally;
iii. Cash being held for other purposes (e.g. earmarked reserves or working capital) but used in the short term for capital investment. This is known as ‘internal borrowing’ as there will be a future need to borrow externally once the cash is required for the other purposes.

Under the Cipfa Prudential Code an authority is responsible for deciding its own level of affordable borrowing within set prudential indicator limits (see section 5.4).

Borrowing does not have to take place immediately to finance its related capital investment and may be deferred or borrowed in advance of need within policy. The Council’s primary objective when borrowing is to strike an appropriately low risk balance between securing low interest rates and achieving cost certainty over the period for which funds are required.

The amount that notionally should have been borrowed is known as the **capital financing requirement (CFR)**. The CFR and actual borrowing may be different at a point in time and the difference is either an under or over borrowing amount.

The Council is required to repay an element of the CFR each year through a revenue charge. This is known as the minimum revenue provision (MRP) and is currently estimated to be £12m for 2016/17. MRP will cause a reduction in the CFR annually.

When MRP is not required to repay debt, it will accumulate as cash balances which will then be invested. **Graph 1** shows that most of the Council's debt is long dated and matures from 2045. Investment balances will therefore be increased by MRP each year until the debt is repaid.

External borrowing has not been needed over the past few years in order to reduce the cost of carry at a time when investment returns are low and counterparty risks continue to be relatively high.

Strategy for 2016/17

The Council's 'Draft Revenue Budget and Capital Programme 2015/16 to 2017/18' forecasts £262.8m of capital investment over the next three years with £193.3m met from existing or new resources. The amount of new borrowing required over this period is therefore £69.4m as shown in **Table 2** below.

Table 2	**2015/16 Projected**	**2016/17 Estimate**	**2017/18 Estimate**	**Total**
	£m	**£m**	**£m**	**£m**
Capital Expenditure	116.4	98.0	48.4	262.8
Financed by:				
Capital Reserves, Capital Grants, Capital Receipts, Revenue Contributions	(109.1)	(42.5)	(41.7)	(193.3)
Borrowing Need	**7.3**	**55.5**	**6.7**	**69.5**

As existing and new resources are insufficient, borrowing of £69.5m will be met initially from internal borrowing. By essentially lending the Council's own surplus funds to itself, the Council will minimise borrowing costs and reduce overall treasury risk by reducing the level of external investments.

With official interest rates forecast to remain low, an internal borrowing strategy could be viewed as being beneficial but is unsustainable in the longer-term. The benefits of internally borrowing will be monitored against the potential for incurring additional costs through deferring new external borrowing into future years when long-term borrowing rates are forecast to rise.

A scenario is that should interest rates fall to a predetermined trigger level, the Council may take advantage of the low rates by securing fixed rate funding of up to £30 million and help mitigate the risk of deferring the borrowing longer term. Interest rates are however forecast to rise over the next period.

Table 3 below includes the figures from Table 2 and shows the actual external borrowing against the capital financing requirement, identifying any under or over borrowing. A scenario is shown below for both before and after £30 million new borrowing over the next period (assumed £30m in 2016/17) over a 15-18 year term.

Table 3a	2015/16 Projected £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing at 1 April	259	255	250	246	241
less loan maturities	(4)	(5)	(4)	(5)	(4)
Borrowing at 31 March	**255**	**250**	**246**	**241**	**237**
CFR at 31 March	256	299	294	282	270
Under/(over) borrowing	**1**	**49**	**48**	**41**	**33**

Table 3b (including £30m potential new borrowing in 2016/17)	2015/16 Projected £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing at 1 April	259	255	280	276	271
less loan maturities	(4)	(5)	(4)	(5)	(4)
add new borrowing	-	30	-	-	-
Borrowing at 31 March	**255**	**280**	**276**	**271**	**267**
CFR at 1 April	261	256	299	294	282
Net Capital Expenditure	7	55	7	-	-
MRP	(12)	(12)	(12)	(12)	(12)
CFR at 31 March	**256**	**299**	**294**	**282**	**270**
Under/(over) borrowing	**1**	**19**	**18**	**11**	**3**

The Council is currently maintaining an under-borrowed position. As at the end of 2015/16 the Council is projected to be under borrowed by £1m, rising to £49m in 2016/17 if no external borrowing is undertaken. This means that the capital borrowing need has not been fully funded with loan debt and cash supporting the Council's reserves, balances and cash flow has been used as a short term measure. With external borrowing of £30 million, the 2016/17 under borrowing amount is reduced to £19m.

Borrowing other than with the PWLB

The Council has previously borrowed mainly from the PWLB, but will continue to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates. Any new borrowing taken out will be completed with regard to the limits, indicators, the economic environment, the cost of carrying this debt ahead of need, and interest rate forecasts. The S151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

One such other source has been **LOBO** (Lender Option Borrower Option) type loans. The Council's debt portfolio contains £35.9m of these products (see **Graph 1**), which could be "called" during 2016/17. A LOBO is called when the Lender (Banks) exercises its right to amend the interest rate on the loan at which point the Borrower (the Council) can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion.

It is likely that the **Local Capital Finance Company Limited (Municipal Bond Agency)**, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the PWLB. This Council has approval to make use of this new source of borrowing as and when appropriate.

The Local Capital Finance Company Limited claims that local authority financing costs could be reduced by up to a prudent 0.20% to 0.25% compared to the certainty rate provided by the PWLB. The Company will offer competition to PWLB but as a result the PWLB could react by reducing its own margins thereby making the Local Capital Finance Company Limited rate unattractive for local authority borrowers. Whilst it is difficult to predict the reaction to the establishment of the Local Capital Finance Company Limited, either way, it has the potential for local authorities to access lower borrowing rates.

Policy on Borrowing in Advance of Need

The Council will not borrow purely in order to profit from investment of extra sums borrowed. Any decision to borrow in advance will be within 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.

Debt Rescheduling

Officers continue to regularly review opportunities for debt rescheduling, but there has been a considerable widening of the difference between new borrowing and repayment rates, which has made PWLB debt restructuring now much less attractive. Consideration would have to be given to the large premiums (cash payments) which would be incurred by prematurely repaying existing PWLB loans. It is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO loans, and other market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

The strategy is to continue to seek opportunity to reduce the overall level of Council's debt where prudent to do so, thus providing in future years cost reduction in terms of lower debt repayments costs, and 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. All rescheduling will be agreed by the S151 Officer.

Continual Review
Officers continue to review the need to borrow taking into consideration the potential increases in borrrowing costs, the need to finance new capital expenditure, refinancing maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Chief Finance Officer will continue to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

5.4 Prudential and Treasury Indicators 2016/17 to 2018/19

The Council's capital expenditure plans are a key driver of treasury management activities. The output of the capital expenditure plans are reflected in prudential indicators. Local Authorities are required to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits or ratios as these are for the authority to set itself.

The Prudential Indicators for 2016/17 to 2018/19 are set out in **Table 4** below:

	Table 4	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
1	**Capital Expenditure £m (gross)** Council's capital expenditure plans	150.0	128.6	84.8
2	**Capital Financing Requirement £m** Measures the underlying need to borrow for capital purposes (including PFI & Leases) Capital Financing Requirement as at 31st March	392	383	367
3	**Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream	6.20%	5.84%	5.44%
4	**Incremental impact of capital investment decisions on council tax** Identifies the revenue costs associated with proposed changes to the three year programme compared to the existing approved commitments	0.00	0.00	0.00

The Treasury Management Code requires that Local Authorities set a number of indicators for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code. The Treasury Indicators for 2016/17 to 2018/19 are set out in **Table 5** below:

	Table 5	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
1	**Authorised Limit for External Debt £m*** The Council is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council.	422	413	397
2	**Operational boundary for external debt £m*** The Council is required to set an operational boundary for external debt. This is the limit which external debt is not normally expected to exceed. This indicator may be breached temporarily for operational reasons.	402	393	377
3	**Upper limit for fixed interest rate exposure*** Identifies a maximum limit for fixed interest rates for borrowing and investments.	100%	100%	100%
4	**Upper limit for variable interest rate exposure*** Identifies a maximum limit for variable interest rates for borrowing and investments.	15%	15%	15%
5	**Maturity Structure of Borrowings*** The Council needs to set upper and lower limits with respect to the maturity structure of its borrowing			
	Upper limit for under 12 months	25%	25%	25%
	Lower limit for under 12 months	0%	0%	0%
	Upper limit for 12 months to 2 years	40%	40%	40%
	Lower limit for over 12 months to 2 years	0%	0%	0%
	Upper limit for 2 years to 5 years	60%	60%	60%
	Lower limit for 2 years to 5 years	0%	0%	0%
	Upper limit for over 5 years	80%	80%	80%
	Lower limit for over 5 years	0%	0%	0%

Note-
**the Treasury Indicators above have been calculated and determined by Officers in compliance with the Treasury Management Code of Practice.*

6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities are:

i. the security of capital;
ii. the liquidity of its investments;
iii. the yield (return).

The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give more priority to the security of its investments.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council stipulates the minimum acceptable credit quality of counterparties for inclusion on the counterparty lending list.

Furthermore, the Council recognises 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 in relation to the economic and political environments in which institutes operate.

The borrowing of monies purely to invest or on-lend and make a return is not permitted and the Council will not engage in such activity.

6.2 Specified and Non-Specified Investments

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 364 days);
- 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 (ie a minimum credit rating as outlined in this strategy) 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;

The previous approved strategy allowed the use of counterparties in countries holding a AAA sovereign credit rating from all three rating agencies, but including the UK who hold a rating of AA+ rating, one notch down from AAA.

Strategy for 2016/17

For 2016/17 it is recommended to include two other sovereign nations and their banks which also hold a AA+ rating, the same rating as the UK. Maximum investment limits and duration periods will remain the same as in the previous strategy at £60 million and one year respectively. The list of countries that qualify using this credit criteria (as at the date of this report) are shown below:

AAA Australia, Canada, Denmark, Germany, Netherlands, Singapore, Sweden and Switzerland

AA+ UK, (current)
AA+ Finland and USA (newly added countries)

This update will allow the Council to further diversify its investment portfolio across well rated and established financial institutions.

Creditworthiness Policy

The Treasury Management Strategy needs to set limits on the amount of money and the time period the Council can invest with any given counterparty. In order to do this the Council uses the Credit Rating given to the counterparty by the three main Credit Rating Agencies (Fitch, Moody's and Standard and Poor's). This forms part of the consistent risk based approach that is used across all of the financial strategies.

Treasury Officers regularly review both the investment portfolio and counterparty risk and make use of market data to inform their decision making. The officers are members of various benchmarking groups to ensure the investment portfolio is current and performing as other similar sized Local Authorities.

The Council as part of its due diligence in managing creditworthiness, uses amongst other information, a tool provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three credit rating agencies.

The Capita Asset Services credit worthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue reliance to just one agency's ratings.

This modelling approach combines credit ratings with the following overlays:

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

This weighted scoring system then produces an end product of 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 provided they have a minimum AA+ soverign rating from three rating agencies:

- Yellow *5 years*
- *Purple* *2 years*
- *Blue* *1 year (semi nationalised UK Bank – NatWest/RBS)*
- *Orange* *1 year*
- *Red* *6 months*
- *Green* *3 months*
- *No Colour* *Not to be used*

Y	***P***	***B***	***O***	***R***	***G***	***N/C***
Up to 5yrs	*Up to 2yrs*	*Up to 1yr*	*Up to 1yrs*	*Up to 6 months*	*Up to 100 days*	*Not to be used*

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. 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.

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

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security, and monitoring their security;
- It has sufficient liquidity in its investments.

All credit ratings are monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services credit worthiness 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.

The counterparties in which the Council will invest its cash surpluses is based on officers assessment of investment security, risk factors, market intelligence, a diverse but manageable portfolio and their participation in the local authority market.

Table 6 below summarises the types of specified investment counterparties available to the Council, and the maximum amount and maturity periods placed on each of these. Further details are contained in section 10.

Criteria for Specified Investments:

Table 6	**Country/ Domicile**	**Instrument**	**Maximum investments**	**Max. maturity period**
Debt Management and Depost Facilities (DMADF)	UK	Term Deposits (TD)	unlimited	1 yr
Government Treasury bills	UK	TD	unlimited	1 yr
Local Authorities	UK	TD	unlimited	1 yr
Lloyds Banking Group • Lloyds Bank • Bank of Scotland	UK	TD (including callable deposits), Certificate of Deposits (CD's)	£60m	1 yr
RBS/NatWest Group • Royal Bank of Scotland • NatWest	UK		£60m	1 yr
HSBC	UK		£60m	1 yr
Barclays	UK		£60m	1 yr
Santander	UK		£60m	1 yr
Goldman Sachs Investment Bank	UK		£60m	1 yr
Standard Chartered Bank	UK		£60m	1 yr

Table 6	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Individual Money Market Funds (MMF)	UK/Ireland/ domiciled	AAA rated Money Market Funds	£60m	Liquidity/instant access
Counterparties in select countries (non-UK) with a Sovereign Rating of at least AA+				
Australia & New Zealand Banking Group	Australia	TD / CD's	£60m	1 yr
Commonwealth Bank of Australia	Australia	TD / CD's	£60m	1 yr
National Australia Bank	Australia	TD / CD's	£60m	1 yr
Westpac Banking Corporation	Australia	TD / CD's	£60m	1 yr
Royal Bank of Canada	Canada	TD / CD's	£60m	1 yr
Toronto Dominion	Canada	TD / CD's	£60m	1 yr
Development Bank of Singapore	Singapore	TD / CD's	£60m	1 yr
Overseas Chinese Banking Corp	Singapore	TD / CD's	£60m	1 yr
United Overseas Bank	Singapore	TD / CD's	£60m	1 yr
Svenska Handelsbanken	Sweden	TD / CD's	£60m	1 yr
Nordea Bank AB	Sweden	TD / CD's	£60m	1 yr
ABN Amro Bank	Netherlands	TD / CD's	£60m	1 yr
Rabobank	Netherlands	TD / CD's	£60m	1 yr
ING Bank NV	Netherlands	TD / CD's	£60m	1 yr
Deutsche Bank	Germany	TD / CD's	£60m	1 yr
DZ Bank	Germany	TD / CD's	£60m	1 yr
UBS	Switzerland	TD / CD's	£60m	1 yr
Credit Suisse	Switzerland	TD / CD's	£60m	1 yr
Danske Bank	Denmark	TD / CD's	£60m	1 yr
* Nordea Bank	Finland	TD / CD's	£60m	1 yr
* Pohjola Bank	Finland	TD / CD's	£60m	1 yr
* JP Morgan Chase	U.S.A	TD / CD's	£60m	1 yr

** Note – a change per the 2016/17 strategy.*

Non-Specified investments are any other types of investment that are not defined as specified. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out in **Table 7** below.

Non specified investments would include any sterling investments and the purchase of shares in the Municipal Bonds Agency (Local Capital Finance Company Limited). The Council will make an investment in the form of shares in the Municipal Bond Agency (Local Capital Finance Company Limited) where the primary purpose is to support the Council's priorities rather than to speculate on the capital sum invested. With the exception of the municipal bonds agency investment, only investments where there is no contractual risk to the capital invested and where the rate of return justifies their use will be entered into

Table 7	Minimum credit criteria	Maximum investments	Max. maturity period
UK Local Authorities	Government Backed	£60m	2 years
Local Capital Finance Company Limited	Local Governement Agency Backed	£100k	N/A

A detailed list of specified and non-specified investments that form the counterparty list is shown in section 10.

6.4 Risk and Sensitivity Analysis

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); and
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

Treasury Officers, in conjunction with the treasury advisers, will monitor these risks closely and particular focus will be applied to:

- 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 credit worthiness methodology and continues to monitor counterparties and sovereign ratings closely particularly within the Eurozone.

7. MINIMUM REVENUE PROVISION POLICY STATEMENT

The statutory requirement for local authorities to charge the Revenue Account each year with a specific sum for debt repayment. A variety of options is provided to councils to determine for the financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This replaces the previous requirement that the minimum sum should be 4% of the Council's Capital Financing Requirement (CFR).

A Statement on the Council's policy for its annual MRP should be submitted to the Full Council for approval before the start the financial year to which the provision relate. The Council is therefore legally obliged to have regard to CLG MRP guidance in the same way as applies to other statutory guidance such as the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG guidance on Investments.

The MRP guidance offers four options under which MRP might be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this annual Treasury Management Policy and Strategy.

The International Financial Reporting Standards (IFRS) involves Private Finance Initiative (PFI) contracts and some leases (being reclassified as finance leases instead of operating leases) coming onto the Council's Balance Sheet as long term liabilities. This accounting treatment impacts on the Capital Financing Requirement with an annual MRP provision being required.

To ensure that this change has no overall financial impact on Local Authorities, the Government has updated their "Statutory MRP Guidance" which allows MRP to be equivalent to the existing lease rental payments and "capital repayment element" of annual payments. The implications of these changes are reflected in the Council's MRP policy for 2016/17.

The policy recommended for adoption from 1 April 2016 retains the key elements of the policy previously approved including provisions regarding PFI, closed landfill, and finance leases. The policy for 2016/17 is therefore as follows:-

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

- Based on based on the non-housing CFR, i.e., The Council currently set aside a Minimum Repayment Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR.

From 1 April 2008 for all unsupported borrowing 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 will be applied for any expenditure capitalised under a Capitalisation Direction).

- Asset Life Method (annuity method) The Council will also be adopting the annuity method, - MRP calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. The policy is being adopted as a result of any PFI's, closed landfill, and finance lease assets coming on the balance sheet and any related MRP will be equivalent to the "capital repayment element" of the annual service charge payable to the PFI Operator and for finance leases, MRP will also be equivalent to the "capital repayment (principal) element" of the annual rental payable under the lease agreement.

Under both methods, the Council has the option to charge more than the statutory MRP each year through a Voluntary Revenue Provision (VRP).

In view of the variety of different types of capital expenditure incurred by the Council, which is not in all cases capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure.

This approach also allows the Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy.

Half-yearly review of the Council's MRP Policy will be undertaken and reported to Members as part of the Mid-Year Treasury Management Strategy report.

7.1 Proposal for a review of the Minimum Revenue Provision

The Council has commissioned Capita Asset Services to undertake a review of the Council's MRP profile. This will involve an extensive review of past and future MRP calculations and Capita will advise the Council on where it may be possible to change the profile MRP for the repayment of its underlying debt liability. This can result in short to medium term benefits to the General Fund and assist with easing current budgetary pressures, whilst ensuring that the provision provided remains prudent and compliant with the statutory guidance for MRP.

8. SCHEME OF DELEGATION

1. **Full Council**
   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 polices, estimates and actuals. These reports are:

   i. **Treasury Management Policy and Strategy Report**
   The report covers:

   - 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; and
   - an investment strategy (the parameters on how investments are to be managed).

   ii. **A Mid-Year Review Report and a Year End Stewardship Report**
   These 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. The reports also provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2. **Cabinet**
   - Approval of the Treasury Management quarterly update reports;
   - Approval of the Treasury Management outturn report.

3. **Audit, Best Value and Community Services Scrutiny Committee**
   - Scrutiny of performance against the strategy.

4. **Role of the Section 151 Officer**
   The Section 151 (responsible) Officer:

   - recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
   - submitting regular treasury management policy reports;
   - submitting budgets and budget variations;
   - receiving and reviewing management information reports;
   - reviewing the performance of the treasury management function;
   - ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
   - ensuring the adequacy of internal audit, and liaising with external audit;
   - recommending the appointment of external service providers.

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

9. OTHER TREASURY ISSUES

9.1 Banking Services

NatWest, which is part Government owned, currently provides banking services for the Council.

9.2 Policy on the use of External Service Providers

The Council uses Capita Asset Services as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the Council 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.

9.3 Lending to third parties

The Council has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments rather they are policy investments. Any activity will only take place after relevant due diligence has been undertaken. Loans of this nature will be approved by Cabinet.

The primary aims of the Investment Strategy 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.

In order to ensure security of the Council's capital, extensive financial due diligence must be completed prior to any loan or investment being agreed. The Council 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.

10. Counterparty List 2016/17

Bank with duration colour	Country	Fitch Ratings				Moody's Ratings		S & P Ratings		CDS Price	ESCC Duration	Capita Duration Limit	Money Limit
Specified Investments:		L Term	S Term	Viab.	Supp.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
Lloyds Banking Group:													
Lloyds Bank	UK	A+	F1	a	5	A1	P-1	A	A-1	47.9	6	6	60
Bank of Scotland	UK	A+	F1	a	5	A1	P-1	A	A-1	53.6	6	6	
RBS/NatWest Group:													
NatWest Bank	UK	BBB+	F2	Bbb+	5	A3	P-2	BBB+	A-2	-	12	12	60
Royal Bank of Scotland	UK	BBB+	F2	Bbb+	5	Ba1	P-2	BBB+	A-3	56.6	12	12	
HSBC Bank	UK	AA-	F1+	a+	1	Aa2	P-1	AA-	A-1+	66.6	12	12	60
Barclays Bank	UK	A	F1	a	5	A2	P-1	A-	A-2	60.0	6	6	60
Santander (UK)	UK	A	F1	a	2	A1	P-1	A	A-1	-	6	6	60
Goldman Sachs IB	UK	A	F1	-	-	A1	P-1	A	A-1	84.6	6	6	60
Standard Chartered Bank	UK	A+	F1	a+	5	Aa2	P-1	A+	A-1	142.1	6	6	60
Non UK Counterparties:													
Australia & New Zealand Banking Group	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	80.8	12	12	60
Commonwealth Bank of Australia	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	79.1	12	12	60
National Australia Bank	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	79.1	12	12	60
Westpac Banking Corporation	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+		12	12	60
Royal Bank of Canada	Canada	AA	F1+	aa	2	Aa3	P-1	AA-	A-1+	-	12	12	60
Toronto Dominion	Canada	AA-	F1+	aa-	2	Aa1	P-1	AA-	A-1+	-	12	12	60
Dev. Bank of Singapore	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	24	60
Oversea Chinese Banking Corp	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	24	60
United Overseas Bank	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	24	60
Svenska Handelsbanken	Sweden	AA-	F1+	aa-	2	Aa3	P-1	AA-	A-1+	-	12	12	60
Nordea Bank AB	Sweden	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	-	12	12	60
ABN AMRO Bank	Netherlands	A	F1	a	5	A2	P-1	A	A-1	65.8	12	12	60
Rabobank	Netherlands	AA-	F1+	-	-	Aa2	P-1	A+	A-1	49.2	12	12	60

Continued Counterparty list **Bank with duration colour**	**Country**	**Fitch Ratings**				**Moody's Ratings**		**S & P Ratings**		**CDS Price**	**ESCC Duration**	**Capita Duration**	**Money Limit**
		L Term	S Term	Viab.	Supp.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
ING Bank NV	Netherlands	A	F1	a	5	A1	P-1	A	A-1	50.7	12	12	60
UBS	Switzerland	A	F1	a	5	A1	P-1	A	A-1	45.8	6	6	60
Credit Suisse	Switzerland	A	F1	a	5	A1	P-1	A	A-1	45.8	6	6	60
Deutsche Bank	Germany	A-	F1	a-	5	A3	P-2	BBB+	A-2	93.1	3	3	60
DZ Bank	Germany	A-	F1			Aa2	P-1	AA-	A-1+		12	12	60
Danske Bank	Denmark	A	F1	a	5	A2	P-1	A	A-1	57.7	6	6	60
Nordea Bank Finland	Finland	AA-	F1+	aa-	5	Aa3	P-1	AA-	A-1+		12	12	60
Pohjola Bank	Finland	A+	F1		5	Aa3	P-1	AA-	A-1+		12	12	60
JP Morgan Chase	U.S.A	AA-	F1+	a+	5	Aa2	P-1	A+	A-1	61.2	12	12	60

Yellow	***Purple***	***Blue***	***Orange***	***Red***	***Green***	***No Colour***
Up to 5yrs	*Up to 2yrs*	*Up to 1yr (semi nationalised UK bank NatWest/RBS)*	*Up to 1yr*	*Up to 6 months*	*Up to 100 days*	*Not to be used*

Non-Specified Investments:			
	Minimum credit Criteria	**Maximum Investments**	**Maximum maturity period**
UK Local Authorities	Government Backed	£60m	2 years
Local Capital Finance Company Limited	Local Government Agency Backed	£100k	N/A

11. GLOSSARY

Basis Point
1/100th of 1%, i.e. 0.01%

Base Rate
Minimum lending rate of a bank or financial institution in the UK.

Callable Deposit
A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen, the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.

Capital Financing Requirement (CFR)
The underlying need to borrow for capital purposes.

Certificate of Deposit (CD)
Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.

Commercial Paper
Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.

Counterparty
Another (or the other) party to an agreement or other market contract (eg lender / borrower / writer of a swap etc.)

CPI
Consumer Price Index - calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time. The CPI covers some items that are not in the RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees.

Credit Rating
An evaluation made by a credit rating agency of an organisations likelihood of default.

Credit Default Swap
CDS - a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.

DMADF
Deposit Account offered by the Debt Management office (DMO), guaranteed by the UK government.

DMO
Debt Management Office. An Executive Agency of Her Majesty's Treasury. The DMO's responsibilities include debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

ECB
European Central bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.

EMU
European Monetary Union

Fed.
Federal Reserve Bank of America – sets the central rates in the USA.

Fixed Term Deposit (FTD)
Investment made with a financial institution for a fixed period at a fixed rate.

FSA (Financial Services Authority)
Body responsible for overseeing financial services.

Fiscal Policy
The Government policy on taxation and welfare payments.

Gilt
Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.

Minimum Revenue Provision (MRP)
Prudent provision for the repayment of debt.

Money Market Fund (MMF)
A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.

Monetary Policy Committee (MPC)
Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment.

PWLB
Public Works Loans Board. A statutory body operating within the DMO and is responsible for lending money to local authorities and other prescribed bodies.

Term Deposit
A deposit held in a financial institution for a fixed term at a fixed rate.

Treasury Bill (T Bills)
Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.