TRAFFORD COUNCIL

Report to:	**Accounts & Audit Committee 11 February 2014** **Executive & Council Meetings 19 February 2014**
Report for:	**Decision**
Report of:	**The Executive Member for Finance and Director of Finance**

Report Title

TREASURY MANAGEMENT STRATEGY 2014/15 – 2016/17

Summary

This report presents the:-

- expected treasury management operations for this period,
- risks that exist and mitigations measures and
- prudential indicators for 2014/15 – 2016/17.

The global economic climate, despite early signs that a recovery maybe underway, remains in a fragile state and it is therefore recommended that the strategy will remain similar to that approved last year.

Recommendation(s)

That the Accounts & Audit Committee & Executive recommend to Council for approval the;

- policy on debt strategy for 2014/15 to 2016/17 as set out in section 3,
- investment strategy for 2014/15 to 2016/17 as set out in section 5,
- Prudential Indicators and limits including the Authorised Limit (as required by section 3(1) of the Local Government Act 2003), Operational Boundary, Minimum Revenue Provision Statement and Investment criteria as detailed in Appendix 1.

Contact person for access to background papers and further information:

Name: Graham Perkins
Extension: 4017

Background papers: None

Relationship to Policy Framework / Corporate Priorities	Value for Money
Financial	The treasury management strategy will aim to maximise investment interest and reduce interest payable on debt, whilst minimising the risk to the Council.
Legal Implications:	Actions being taken are in accordance with legislation, CIPFA Prudential Code and CIPFA Treasury Management Code of Practice.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	The overriding aim will always be to minimise risk and in respect of this the annual strategy report will therefore remain a cornerstone of the treasury management decision making process.
Health and Safety Implications	Not applicable

Other Options

This report has been produced in order to comply with Financial Procedure Rules and relevant legislation. It provides a plan of action for the period 2014-15 to 2016-17, which is flexible enough to take account of changes in financial markets.

Consultation

Advice has been obtained from Capita, the Council's external advisors.

Reasons for Recommendation

The Financial Procedure Rules, incorporating the requirements of the revised CIPFA Prudential Code and the CIPFA Treasury Management Code. These consider that the annual strategy report is an essential control over treasury management activities whereby Members approve the parameters under which officers will operate. In addition The Local Government Act 2003 requires that the Council approves an annual borrowing limit (the Authorised Limit) and CLG Guidance an annual investment strategy (setting out the limits to investment activities).

Key Decision

This will be a key decision likely to be taken in: February 2014
This is a key decision currently on the Forward Plan: Yes

Treasury Management Strategy – Summary of Key Points

This report outlines the expected treasury activities for the forthcoming 3 years and has been prepared in accordance with the Council's Financial Procedure Rules. Additional treasury management reports are produced during the course of the year reporting actual activity for the preceding year and a mid-year update.

Economic situation (Appendix 4)

During the second half of 2013, signs that global economic recovery was underway emerged, however this position remains fragile.
Main economic headlines were;

- UK reported positive growth throughout 2013 with unemployment levels falling to 2.3m (7.1%) in December 2013,
- The Eurozone sovereign debt crisis eased despite Cyprus needing a bailout in the Spring,
- US economy continued to recover despite protracted fiscal negotiations, often taken to the last minute, approving stringent federal expenditure cuts and increases in taxation; and
- China's economy averted a hard landing and Japan saw growth.

Debt (Section 3)

In line with previous years practice, no external loans were taken to fund the Council's capital investment requirement. As a consequence of this action, the internal borrowing position (cash backed reserves, balances and cash flow being used rather than taking on new debt) will be at £45.0m by 31 March 2015 and generate a saving in loan interest payable of £2.0m. This approach, which has been adopted by the majority of councils, reduces both the risks associated with investment counterparties and the large difference between debt costs and investment returns.

Debt restructuring exercises will only be undertaken in order to produce revenue savings or lower overall treasury risk.

Investments (See Section 5 and Appendix 1)

The primary principles governing the Council's investment criteria remains unchanged from that previously adopted of security of capital first, liquidity of its cash flows and finally yield.

The Council is required to agree the lending criteria, which is primarily determined by credit ratings issued by all 3 major credit rating agencies as detailed at Appendix 1. *The only recommended change to that previously agreed by Council in February 2013 relates to the decrease in the maximum duration amounts that can be lent to both the UK part nationalised banks and the Council's own bank.*

Prudential Indicators and limits (Section 7 and Appendix 1)

The Council is required to approve a set of Prudential Indicators and limits which ensure the Council's capital expenditure plans and borrowing remain robust, prudent, affordable and sustainable. These are detailed at Appendix 1 for Member approval.

1. Background

Please note a glossary of all abbreviations appears at Appendix 7 for reference.

1.1 Treasury management is an important part of the overall financial management of the Council's affairs and is undertaken in accordance with statutory requirements together with the CIPFA Treasury Management Code of Practice. A brief outline of these has been provided at Appendix 2.

1.2 The main task of Treasury management is to ensure that adequate cash is available to meet the Council's cash flow requirements together with the management of its long and short term loans with any temporary surplus monies invested in low risk counterparties.

1.3 Each year in order to comply with the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), the Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals as follow;

- annual treasury strategy for the year ahead (February i.e. this report)
- mid-year update report (November)
- annual report on the activity undertaken compared to the strategy (June).

1.4 The Council uses Capita, formerly Sector, as its treasury management advisors who provide arange of services from technical support on treasury matters to the supply of credit ratings as issued by the three main credit rating agencies.

1.5 Whilst the advisors provide support to the internal treasury management function, the Council recognises that the final decision on all treasury management matters remains with the organisation at all times. This service is subject to regular review.

1.6 The Council recognises the importance of ensuring that all Members and staff involved in the treasury management function receive adequate training and are fully equipped to undertake the duties and responsibilities allocated to them by ensuring that;

- Members will continue to have access to training which will be relevant to their needs & responsibilities;
- Officers will attend courses / seminars presented by CIPFA, LGC, Advisors & any other suitable professional organisation in accordance with Council policy on this issue.

1.7 Excluded from this report are the activities carried out by the Council's schools, which operate within separate criteria as stipulated by the Director of Finance and in accordance with the Council's Financial Procedure Rules.

2. Economic & Interest Rate forecast

2.1 Signs started to appear in 2013/14 that a global recovery was underway, however the economic climate continues to remain in fragile state. During 2013/14 the main economic headlines are outlined at Appendix 4 for reference.

2.2 Economic forecasting remains difficult, particularly with many external influences affecting the UK economy e.g. will the Eurozone recovery continue? Market forecasters currently predict that the UK economic recovery, which started mid-year in 2013, is set to continue and that the main headlines for 2014/15 are as follows:

- UK bank rate, currently at 0.5%, is not expected to move until 2016;
- Consumer Price Inflation to remain around the 2% Government target Level;
- The Bank of Endland's latest forecast for growth in the UK economy for 2014 is 2.8% an increase of 1.1% from its original forecast of 1.7%;
- UK continues to be seen as a safe haven for foreign investors.

2.3 Capita, the Council's external treasury management advisors, has produced a set of interest rate forecasts up to March 2017;

Annual Average %	**Bank Rate**	**Investment Rates**		**Borrowing Rates**	
		3 month LIBID	**1 year LIBID**	**5 year**	**25 year**
2013/14	0.50	0.50	0.80	2.70	4.60
2014/15	0.50	0.50	0.80	2.90	4.75
2015/16	0.50	0.50	1.10	3.20	5.05
2016/17	1.00	0.90	1.95	3.50	5.30

2.4 As a result of this economic position, the Council will take a cautious approach to its treasury strategy during this period.

3. Debt Strategy 2014/15 – 2016/17

3.1 The Council maintains an under-borrowed position. This position has resulted from the underlying borrowing need arising from the capital programme and historic capital decisions (the Capital Financing Requirement, CFR), not been fully funded by taking on external debt. Instead cash supporting the Council's reserves, balances and cash flow has been used to finance this requirement.

3.2 The table below shows the actual external debt levels against the underlying capital borrowing need (the Capital Financing Requirement - CFR) highlighting the Council's under-borrowing position.

	2013/14	**2014/15**	**2015/16**	**2016/17**
	Estimate £000	**Estimate £000**	**Estimate £000**	**Estimate £000**
Debt at 1 April	100,473	97,417	94,992	97,922
Debt maturing	(3,056)	(2,425)	(1,770)	(3,747)
New Debt	0	0	4,700	4,600
Actual gross debt at 31 March	97,417	94,992	97,922	98,775
Capital Financing Requirment at 31 March	146,266	140,013	138,334	138,321
Under borrow at 31 March	48,849	45,021	40,412	39,546

3.3 The strategy of not undertaking any external borrowing, which the Director of Finance under delegated powers has adopted, is set to continue for 2014/15. Based on the forecasted closing position at 31 March 2015 in the table above, this will save the Council £2.0m in loan interest payable (£45.0m x 4.5%).

3.4 Subject ot Council approval, in order to finance the Council's L.E.D. street lighting replacement programme, as approved at 18 November 2013 Executive meeting, it is likely that new debt will be taken in line with the current forecasted spend profile. This will commence in 2015/16, with all debt costs being met from savings generated from reduced maintenance and energy costs.

3.5 In addition to the borrowing undertaken directly, the Council is also responsible for a further £1.0m which is administered by Tameside Borough Council on behalf of all the 10 Greater Manchester Authorities. This follows the conversion in February 2010 of loans previously held on behalf of Manchester International Airport into an equity rated instrument.

3.6 As short term borrowing rates will be cheaper than longer term fixed interest rates, there may be potential opportunities in the future to generate revenue savings by switching from long term debt to short term debt. However the cost of premiums incurred, due to early repayment, will also need to be taken into account before any restructuring is undertaken.

3.7 The Council is required to set its limits for external debt for 2014/15 to 2016/17 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code before the commencement of each financial year. **These limits are detailed at Appendix 1 for Council approval.**

3.8 The Council retains the flexibility to borrow funds in advance of requirement should market conditions unexpectedly change i.e. anticipate a sharp rise in interest rates, however funds will not be taken purely in order to profit from investment of the extra sums borrowed. This course of action will be done in accordance with the Director of Finance's delegated powers and reported to Members through either the mid-year or annual reporting mechanism.

3.9 Any borrowing undertaken in this way by The Director of Finance will be done within the constraints stated below;

- no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period is to be taken in this manner and
- borrowing only up to a maximum 12 months in advance of need.

3.10 A breakdown of the Council's expected debt maturity profile as at 31 March 2014 is provided at Appendix 5 for reference which also shows, in accordance with the Code of Practice, the potential first date the lending banks could amend the rate of interest for the market loans.

4. Minimum Revenue Provision Strategy

4.1 The Council is required to set aside an amount each year for the repayment of debt (by reducing the CFR), through a revenue charge called the Minimum Revenue Provision (MRP). In addition, the Council is also allowed to undertake voluntary revenue payments (VRP).

4.2 CLG regulations require full Council to approve an MRP Policy in advance of each year. A variety of options are provided to councils so long as there is a prudent provision. **The Council is requested to approve the MRP statement as detailed at Appendix 1.**

5. Investment Strategy

5.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments and the revised CIPFA Treasury Management in Public Services Code of Practice.

5.2 The primary principle governing the Council's investment criteria is the security of its investments and in order to comply with this, the Council's investment priorities will therefore remain unchanged to that previously adopted;

- security of capital,
- liquidity of its cash flows and
- yield.

5.3 In accordance with the above guidance from the CLG & CIPFA and in order to minimise the risk of a counterparty defaulting, the Director of Finance will maintain, as in previous years, a list comprising of high creditworthy counterparties with whom funds can be invested with.

5.4 The creditworthiness methodology used to create the counterparty list uses the credit ratings issued by all three of the main rating agencies (Fitch, Moody's and Standard and Poor's) and is based on the lowest common denominator approach which defaults to the lowest equivalent rating.

5.5 This approach, which uses real time credit rating information, enables a counterparty to be included on this list using the latest ratings from at least two of the three independent rating agencies, providing the ratings meet all the minimum levels required by the Council as shown at Appendix 1.

5.6 Any counterparty featuring on the Council's list of authorised institutions which incurs a negative rating change which means it no longer meets the minimum required, will be immediately suspended from use and removed from the authorised list.

5.7 A full explanation of the credit ratings determining the counterparties which the Council will use can be found at Appendix 3.

5.8 The Council officers further recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor each counterparty taking into account market opinions, financial press, equity & credit default swap prices. This additional market information is detailed for Members' reference at Appendix 3.

5.9 The overall aim of this approach is to produce a list of high creditworthy counterparties enabling investments to be placed with a wide spectrum of institutions.

5.10 The criteria for providing a list of high quality investment counterparties (both Specified and Non-specified), and reducing exposure of the Council's investments by country, group and sector are explained in more detail at Appendix 3 together with time and value limits.

5.11 The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded and will be limited to the Prudential Indicator detailed at Appendix 1.

5.12 Investments will be made with reference to the Council's cash flow requirements as well as the outlook for investment rates and it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

5.13 The criteria for choosing counterparties as set out at Appendix 1 provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria, the Director of Finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval should any exceptional market conditions be encountered. These restrictions would remain in place until the banking system returned to “normal” conditions. Similarly the time periods for investments will be restricted.

5.14 In conjunction with both the Government’s commitment to commence the process of privatising the part nationalised banks and thereby reducing the level of support offered together with the Council’s own bank which it uses for transactional purposes having its credit ratings downgraded to sub investment levels, **it is recommended to reduce the maximum period funds can be placed as outlined at Appendix 1**

5.15 The minimum criteria for providing a list of high quality investment counterparties, instruments and limits to be applied are highlighted at **Appendix 1** and Council is requested to approve these requirements.

6. Investment Risk Benchmarking

6.1 The Code of Practice and CLG Investment Guidance require that appropriate security and liquidity benchmarks are considered and reported to Members and these are explained in more detail in Appendix 3.

6.2 These benchmarks are simple guides to maximum risk (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. Their purpose is to assist officers to monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported to Members, with supporting reasons in the Mid-Year or Annual Report. For reference these benchmarks will be;

- Security - for each individual year the security benchmark when compared to historic default rates are not to exceed:

1 year investments	2 year investments	3 year investments
0.09%	**0.04%**	**0.14%**

- Liquidity - In respect of this the Council seeks to maintain;
  Bank overdraft of £0.5m,

  Weighted Average Life (WAL) benchmark for 2014/15 is set at 6 months, with a maximum of 3 years,

  Liquid short term deposits of at least £15m are available with a week’s notice

- Yield benchmarks are currently used to assess investment performance and internal returns are required to achieve above the 7 day LIBID rate.

7. Prudential Indicators

7.1 A number of prudential indicators have been devised for both the treasury management and capital operations. These are designed to assist managing risk and reducing the impact of an adverse movement in interest rate as well as ensuring that the Council’s capital expenditure plans are prudent, affordable and sustainable. These indicators have been set in order that they are not too restrictive thereby impairing the opportunities to reduce costs and reflect the capital programme proposals, included within the main budget report.

7.2 Members are requested to approve the prudential indicators for both the Council's capital expenditure and treasury management activities as detailed at **Appendix 1**.

8. Recommendations

That the Accounts & Audit Committee and Executive recommend to Council the key elements of this report for approval;-

- **the policy on debt strategy for 2014/15 to 2016/17 as set out in section 3;**
- **the investment strategy for 2014/15 to 2016/17 as set out in section 5;**
- **the Prudential Indicators and limits including the Authorised Limit (as required by section 3(1) of the Local Government Act 2003), The Minimum Revenue Provision Statement and Investment criteria as detailed in Appendix 1.**

Finance Officer Clearance *……ID ………..*

Legal Officer Clearance *… MJ………*

Director of Finance Signature Appended in hard copy

ELEMENTS FOR COUNCIL APPROVAL
(including Prudential Indicators, Minimum Revenue Provision & Investment Criteria)

In accordance with CLG Guidance, the CIPFA Prudential Code and the CIPFA Code of Practice on Treasury Management each council is required to set, before the commencement of each financial year, Treasury Management Prudential Indicators and limits, a Minimum Revenue Provision Statement and Investment criteria.

The Accounts and Audit Committee and Executive are requested to recommend that Council approve these for the period 2014/15 – 2016/17 as detailed below;

PRUDENTIAL INDICATORS AND LIMITS

In accordance with the CIPFA Prudential code, the Council is required to produce prudential indicators and limits reflecting the expected capital activity regarding its capital investment programme. These have an impact on the Council's treasury management activities and the Council is required to approve the prudential indicators and limits affecting treasury management performance as shown below;

Prudential Indicators	2013/14 estimate £m	2014/15 estimate £m	2015/16 estimate £m	2016/17 estimate £m
(1) Upper Limits – Fixed interest rate exposure (interest costs)	**3.6**	**3.2**	**3.1**	**2.8**
(2) Upper Limits – Variable interest rate exposure (interest costs)	**1.9**	**3.1**	**3.1**	**3.1**
Upper Interest Limits – identifies the maximum limit for both fixed and variable interest rates exposure based upon the Council's debt position net of investments (debt interest payable less investment interest receivable).				
(3) Authorised Limit for External debt				
- External debt (01.04)	120	120	120	120
- Other long term Liabilities (PFI)	7	7	7	6
Total	**127**	**127**	**127**	**126**
Authorised external debt limit - maximum level of external debt that the authority will require to cover all known potential requirements and includes headroom to cover the risk of short-term cash flow variations that could lead to a need for temporary borrowing. This limit needs to be set or revised by Council and is the statutory limit determined under section 3(1) of the Local Government Act 2003.				
(4) Operational Boundary Limit for External debt				
- External debt (01.04)	100	100	100	100
- Other long term	7	7	7	6

Liabilities (PFI)				
Total	**107**	**107**	**107**	**106**
Operational boundary - calculated on a similar basis as the authorised limit but represents the likely level of external debt that may be reached during the course of the year excluding any temporary borrowing and is not a limit.				
(5) Upper limit for sums invested over 364 days	**50**	**50**	**40**	**30**
Upper Limit for sums invested for over 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.				
(6) Gross debt and Capital Financing Requirement				
-External debt (01.04)	100	100	100	100
-Other long term Liabilities (PFI)	7	7	7	6
Gross debt	107	107	107	106
-C.F.R.	146	140	138	138
Excess C.F.R.	**39**	**33**	**31**	**32**
Gross Debt and the Capital Financing Requirement – this indicator reflects that over the medium term, debt will only be for capital purposes. The Director of Finance will ensure that all external debt does not exceed the capital financing requirement with any exceptions being reported to Council.				

MATURITY STRUCTURE of BORROWING 2014/15 to 2016/17		
	Lower limit %	**Upper limit %**
Under 12 months	0	70
12 months to 2 years	0	25
2 years to 5 years	0	25
5 years to 10 years	0	25
10 years to 20 years	0	25
20 years to 30 years	0	25
30 years to 40 years	0	25
40 years and above	0	25
Maturity Structure of Borrowing – these gross limits are set to reduce the Council's exposure to large sums falling due for refinancing and this indicator reflects the next date on which the lending bank can amend the interest rate for the Lender Option Borrower Option loans.		

All the prudential indicators are monitored on a regular basis. If the situation arises that any of the prudential indicators appear that they will be breached for a sustained period, then this will be reported to the Council at the earliest opportunity.

<u>MINIMUM REVENUE PROVISION - </u>(no change)

In accordance with C.L.G. Guidance, the Council shall determine for the current financial year, an amount of minimum revenue provision that it considers to be prudent and submit an MRP Statement setting out its policy for its annual MRP to Council for approval. The following MRP Statement has been prepared in accordance with the Council's accounting procedures as stated in the annual Statement of Accounts publication and is recommended for approval:

- Capital expenditure incurred before 1 April 2008 or which in the future will be supported by external borrowing approvals -, the MRP policy will follow the existing practice outlined in former C.L.G. regulations, i.e. 4% of the C.F.R. each year;
- Capital expenditure incurred after 1 April 2008 by prudential borrowing (unsupported) -, the policy will be based on the estimated life of the assets once operational with MRP charged on a straight line basis or annuity basis in accordance with the Guidance;
- MRP regarding PFI schemes and leases shown on the balance sheet will be based on the amount of the principal lease repayment included within the annual unitary payments made;
- For expenditure that does not create an asset, or following the use of a Capitalisation Direction, provision will be made over a period not exceeding 20 years, in accordance with Guidance.
- The Council participated in the national Local Authority Mortgage Scheme using the cash backed option with Lloyds bank. This involved the Council placing 2 five year deposits totalling £3m, (£2m 2012/13 & £1m 2013/14), with the bank matching the five year life of the indemnities. These deposits provide an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity and once received will be classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The Council will also apply this policy to other service debt arrangement it should enter into.

<u>INVESTMENT CRITERIA</u> – (recommended changes as highlighted)
The minimum criteria for providing a list of high quality investment counterparties is highlighted in the categories below and these are to be applied for both Specified and Non-specified investments;

	Fitch (or equivalent) – Long Term	Maximum Group Limit	Maximum Time Limit
Category 1 – All UK or Non UK banks and building societies domiciled in a non-UK country which has a minimum Sovereign long term	AA- To AAA A- to A+	£20m £5m	3yrs 1yr

rating of AA and individual credit rating issued by Fitch, Moody's and Standard and Poor's of: • Short Term – Fitch F1 or equivalent • Long Term – Fitch A- or equivalent • Viability / Financial Strength – C (Fitch / Moody's only) • Support – 3 (Fitch only).			
Category 2 – UK Banks part nationalised -	-	£20m	1yr (current limit 3yr)
Category 3 – The Council's own banker if the bank falls below the above criteria for transactional purposes only.	-	n/a (current limit £5m)	1day (current limit 1yr)
Category 4 – • Money Market Funds – must be AAA credit rated • UK Government (including treasury bills, gilts and the DMO) • Local Authorities • Supranational Institutions • Corporate bonds (Manchester International Airport only)	-	£20m	3yrs

Specified and Non Specified Investments – (recommended change as highlighted)

In accordance with the Code of Practice, the Council is required to set a criteria which identifies its investments between Specified and Non Specified investments and these are classified as follows;

- Specified investments are high security and high liquidity investments with a maturity of no more than a year or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. A maximum of 100% can be held under this definition,

- Non specified investments are any other type of investment not defined as specified above with the maximum permitted to be held in this classification detailed in Appendix 1 including Manchester Airport Shares at 31 March 2013 of £29.3m and

- Local Authority Mortgage Scheme. Under this scheme, which is designed for first time buyers to be able purchase a property in the area, the Council is required to place funds of £3m with Lloyds bank for a period of 5 years to match the 5 year life of the indemnity. This is classified as being a service investment, rather than a treasury management investment and is therefore outside of the specified / non specified categories.

All Investments will be undertaken in Sterling in the form of Term Deposits, Money Market Funds, or Certificates of Deposits unless otherwise stated below,

Specified Investments

Investment	Maximum Maturity
The UK Government including Local Authorities, Debt Management Office, UK Treasury Bills or gilts with less than one year to maturity.	1 Year
Supranational bonds of less than one year duration	1 Year
Pooled investment vehicles that have been awarded a AAA credit rating by Fitch, a credit rating agency, such as money market funds	1 Year
An institution that has been awarded a high short term credit rating (minimum F1 or equivalent) by a credit rating agency, such as a bank or building society.	1 Year

Non-Specified Investments

Investment	Maximum Maturity
Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). The security of interest and principal on maturity is on a par with the Government and so are very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	3 Years
Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. The value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	3 Years
The Council's own bank if it fails to meet the basic credit criteria.	1 Day (current limit 1 Year)
UK Banks which have significant Government holdings	1 Year
Any bank or building society which meets the minimum long term credit criteria detailed in Appendix 1, for deposits with a maturity of greater than one year.	3 Years
The UK Government including Local Authorities, Debt Management Office, UK Treasury Bills or Gilts	3 Years

Share capital or loan capital in a body corporate – The use of these instruments maybe deemed to be capital expenditure, and as such maybe an application (spending) of capital resources. It is envisaged this facility will apply to the Manchester International Airport share holding which the Council holds at a historical value of £29.3m as reported in the 2012/13 statement of accounts. It is not envisaged that this type of investment will be undertaken in the future.	3 Years
Manchester Airport Group – This is in response to the restructuring of the airports existing debt and is included for clarity and transparency purposes only.	Term of loans

APPENDIX 2

STATUTORY FRAMEWORK

Local Government Act 2003

In accordance with the Local Government Act 2003 (and supporting regulations and guidance) each Council must before the commencement of each financial year, produce a report fulfilling three key requirements as stipulated below;

- The debt strategy in accordance with the CIPFA Code of Practice on Treasury Management (section 3);
- The investment strategy in accordance with the Communities and Local Government (C.L.G.) investment guidance (section 5);
- The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities (Appendix 1).

CIPFA Code of Practice

The Council's treasury activities are strictly regulated by statutory requirements in conjunction with a professional code of practice (the CIPFA Treasury Management Code of Practice). This Council adopted the Code of Practice on Treasury Management on 24 April 2002 and followed recommended practices by considering an annual Treasury Management Strategy before the commencement of each financial year. These Codes are revised from time to time and the Council complies with any revisions.

CIPFA defines treasury management as *"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions(debt); the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".*

Investment Guidance

The C.L.G. issued Investment Guidance in March 2010, and this forms the structure of the Council's policy below,

- The strategy guidelines for decision making on investments, particularly non-specified investments.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.
- The principles to be used to determine the maximum periods for which funds can be committed.

APPENDIX 3

INVESTMENT CREDIT AND COUNTERPARTY RISK MANAGEMENT
(No change)

The Council receives credit rating advice from its treasury management advisors, as and when ratings change and counterparties are checked promptly to ensure it complies with the Council's criteria. The criteria used are such that any minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria, or those on the minimum criteria placed on negative credit watch, will be removed from the list immediately, and if required new counterparties which meet the criteria will be added to the list.

		Credit Rating Agency		
Classification	**Description**	**Fitch** (Minimum)	**Moody's** (Minimum)	**Standard & Poors (Minimum)**
Short Term	Ensures that an institution is able to meet its financial obligations within 12 months	F1 (Range **F1+, F2 A** to **D**)	P1 (Range **P1** to **P3**)	A1 (Range **A-1,** to **C**)
Long Term	Ensures that an institution is able to meet its financial obligations greater than 12 months	A- (Range **AAA** to **D**)	A3 (Range **AAA** to **C**)	A- (Range **AAA** to **CC**)
Viability / Financial Strength	Assess how an institution, in the event of financial difficulty, would be viewed if it were entirely independent and could not rely on external support.	C (Range **A** to **E**)	C (Range **A** to **E**)	N/a
Support	Indicates state support would be forthcoming in the event of financial difficulty	3 (Range **1** to **5**)	N/a	N/a

Investment Counterparty information.

Whilst the Council's Investment counterparty list is prepared primarily using credit rating information, additional market information is also required to also be considered. The information below will continue to be considered when undertaking investments;

- Credit default swaps - CDS created in 1997 and are a financial instrument for swapping the risk of debt default. Essentially the owner of the position would enter into an agreement with a third party who would receive a payment in return for protection against a particular credit event – such as default. Whilst absolute prices can be unreliable, trends in CDS spreads do give an indicator of relative confidence about credit risk.

- Equity prices – like CDS prices, equities are sensitive to a wide array of factors and a decline in share price may not necessarily signal that the counterparty in question is in difficulty.
- Interest rates being paid - If a counterparty is offering an interest rate which is out of line with the rest of the market this could indicate that the investment is likely to carry a high risk.
- Information provided by management advisors – this is may include some information detailed above together with weekly investment market updates.
- Market & Financial Press information – information obtained from the money market brokers used by the Council in respect of interest rates & Counterparties will also be considered.

Investment Limits

In order to safeguard the Council's investments and in addition to the information shown at Appendix 1 due care will be taken to consider country, group and sector exposure as follows;

- The country selection will be chosen by the credit rating of the Sovereign state as shown at Appendix 1 and no more than 40% of the Council's total investments will be directly placed with non-UK counterparties at any time;
- limits in the table below will apply to Group companies (e.g. a group equates to Royal Bank of Scotland / Nat West);
- Sector limits will be monitored regularly for appropriateness.

Investment Risk benchmarking

Security and liquidity benchmarks are central to the approved treasury strategy through the counterparty selection criteria and proposed benchmarks for these are set out below.

Security - A method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table below shows average defaults for differing periods of investment grade products for each Fitch/Moody's and Standard and Poors long term rating category over the period 1990 to 2011.

Long term rating	Average 1 yr default	Average 2 yr default	Average 3 yr default	Average 4 yr default	Average 5 yr default
AAA	**0.00%**	**0.02%**	**0.06%**	**0.09%**	**0.13%**
AA	**0.02%**	**0.04%**	**0.14%**	**0.28%**	**0.36%**
A	**0.09%**	**0.25%**	**0.43%**	**0.60%**	**0.79%**
BBB	**0.23%**	**0.65%**	**1.13%**	**1.70%**	**2.22%**
BB	**0.93%**	**2.47%**	**4.21%**	**5.81%**	**7.05%**
B	**3.31%**	**7.89%**	**12.14%**	**15.50%**	**17.73%**
C	**23.15%**	**32.88%**	**39.50%**	**42.58%**	**45.48%**

The Council's minimum long term rating criteria is currently "A", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.09% of the total investment (e.g. for a £1m investment the average loss would be £900). This is only an average as any specific counterparty loss is likely to be higher.

Liquidity – The CIPFA Treasury Management Code of Practice defines this as "*having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable at all times to have the level of funds* *available which are necessary for the achievement of its business/service objectives"*.

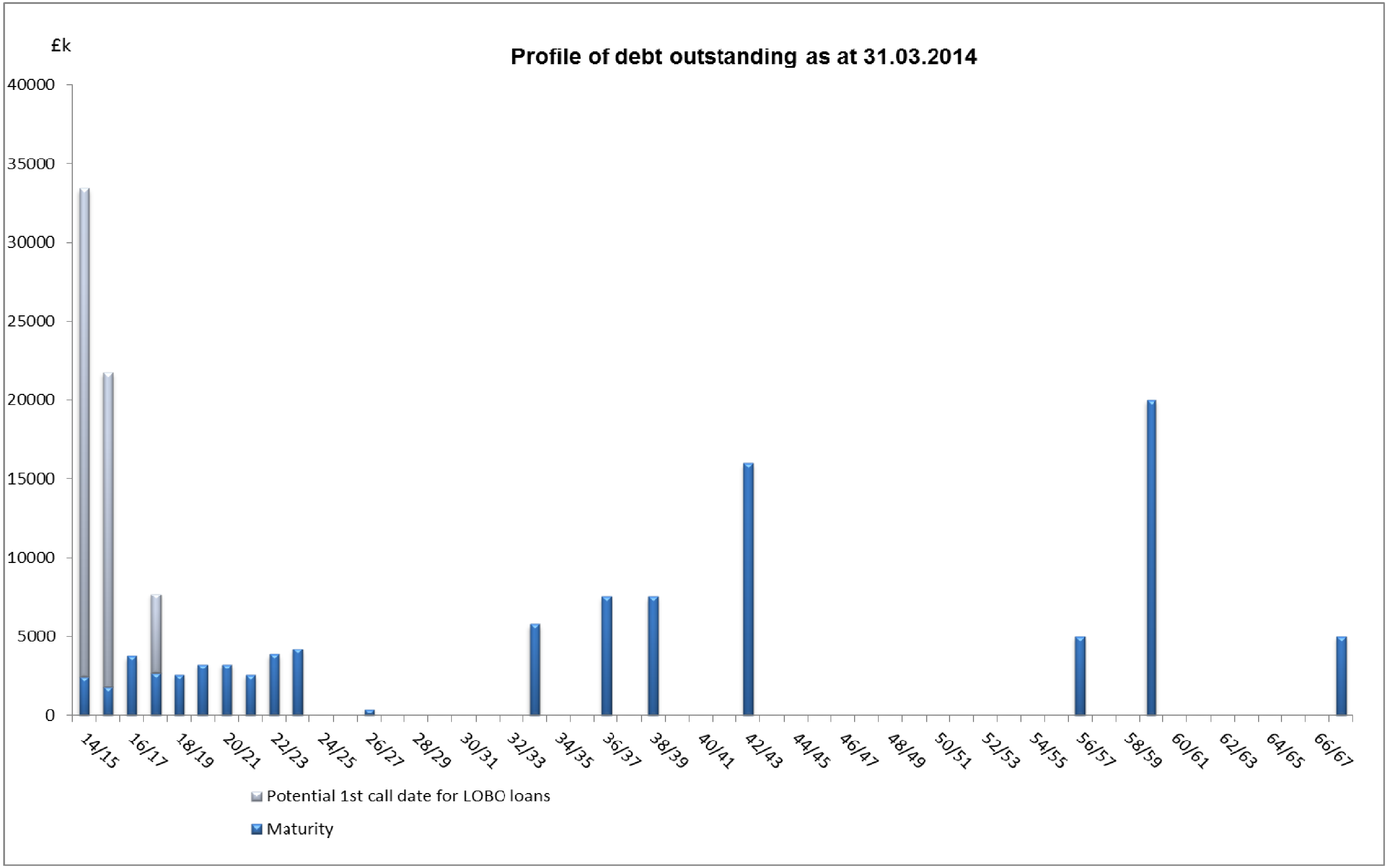
The availability of liquidity and the period of risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio (shorter WAL would generally represent less risk).

MAIN ECONOMIC HEADLINES DURING 2013/14

- **UK economy**-
    - An expected dip back into recession was avoided with positive growth in all sectors being reported for 2013 of 1.9%, the strongest rate since 2007,
    - The Bank of England upgraded it growth forecasts for 2013 from 1.2% to 1.4% during the Summer 2013,
    - Wage inflation continues to remain significantly below Consumer Price Index Inflation;
    - Forward guidance was issued by the Bank of England stating that it would not start to consider raising the Bank Rate, which remained at 0.5% in 2013, until the jobless rate fell to 7.0%;
    - The level of unemployment benefit claimants fell to 7.1% in December 2013, its lowest in 3 years;
    - The Bank of England's Funding for Lending scheme was reviewed to focus more on small businesses and to exclude mortgage borrowers in order to avoid the housing market overheating.
    - Consumer Purchases Index (CPI) fell from its peak of 2.9% in June 2013 to 2.0% in December 2013, the lowest level since November 2009,
    - The UK lost its AAA sovereign credit rating in February & March 2013 as issued by Moody's and Fitch respectively however this caused little market reaction.

- **Eurozone** –
    - The sovereign debt crisis eased during 2013 despite Cyprus seeking a bailout in the Spring;
    - Positive growth was achieved in both the second & third quarters of 2013 following six successive quarters of negative growth;
    - Italy has the third biggest level of debt in the world behind Japan & US;
    - Greece continues to struggle to meet Eurozone targets;
    - European Central Bank reduced its central policy rate from 0.5% to 0.25%.
- **US** –
    - The economy continued to grow with positive growth figures being reported for the first 3 quarters in 2013 of 1.1%, 2.5% & 4.1% respectively. This was achieved despite the fiscal cliff induced sharp cuts in federal expenditure and increases in taxation;
    - The Federal Reserve announced in November that it will reduce the level of its Quantitative Easing (QE) programme assistance from $85bn to $75bn per month. It also pledged not to increase its central rate until unemployment falls to 6.5%;
    - Consumer, Investor and business confidence levels improved in 2013;

  - Unemployment levels fell by 0.8% to 7.0% in November from 7.8% in January 2013;
  - A turn around in the housing market has occurred as reflected by increases in both sales and prices.
- **Other** –
  - China's economy averted a hard landing, however concerns still remain around an unbalanced economy;
  - Japan's economy started to show signs of improving, reporting positive growth for the first 3 quarters in 2013 of 0.9%, 0.5% & 0.3% respectively.


£k
Profile of debt outstanding as at 31.03.2014
40000
35000
30000
25000
20000
15000
10000
5000
0
14/15
16/17
18/19
20/21
22/23
24/25
26/27
28/29
30/31
32/33
34/35
36/37
38/39
40/41
42/43
44/45
46/47
48/49
50/51
52/53
54/55
56/57
58/59
60/61
62/63
64/65
66/67
Potential 1st call date for LOBO loans
Maturity

APPENDIX 5

APPENDIX 6

INVESTMENT & EXTERNAL DEBT PORTFOLIO AS AT 31.12.2013

	Principal £m	Average Rate %
DEBT		
Fixed rate:		
- PWLB	42.8	7.16
- Market	25.0	2.49
Sub-total	67.8	5.44
Variable rate:		
- PWLB	0.0	0.0
- Market	31.0	4.58
Sub-total	31.0	4.58
Total debt	**98.8**	**5.17**
INVESTMENTS		
- Fixed rate	(31.5)	0.93
- Variable rate	(14.6)	0.52
Total Investments	**(46.1)**	**0.80**
NET ACTUAL DEBT	**52.7**	

APPENDIX 7

GLOSSARY of ABBREVIATIONS

CDS	Credit Default Swaps – financial instrument for hedging against counterparty default
CLG	Communities & Local Government (Department of)
CIPFA	Chartered Institute of Public Finance & Accountancy
CFR	Capital Financing Requirement – this is a measure of the council's borrowing needs in order to finance its capital investment programme.
DMO	Debt Management Office – low credit risk UK Government investment Counterparty which offers low rates of return
LGC	Local Government Chronicle
LIBID	London Interbank BID interest rate – average rate of interest offered by the UK clearing banks
MRP	Minimum Revenue Provision – this is the amount required to pay off an element of the capital spend each year through a revenue charge
MTFP	Medium Term Financial Plan – 3 year financial plan
PFI	Private Finance Initiative – private sector source of funding
PWLB	Public Works Loan Board
TMP	Treasury Management Practices – details the methods in which the Council will achieve the treasury management policies and objectives and how it will manage and control them.
VRP	Voluntary Revenue Provision – identical to MRP but on a voluntary basis
WAL	Weighted Average Life – benchmark indicating average life of investments