TRAFFORD COUNCIL

Report to:	**Accounts & Audit Committee 10 February 2015** **Executive & Council Meetings 18 February 2015**
Report for:	**Decision**
Report of:	**The Executive Member for Finance and Director of Finance**

Report Title

TREASURY MANAGEMENT STRATEGY 2015/16 – 2017/18

Summary

This report outlines the:-

- strategy to be followed during this period for investments and borrowing,
- outlook for interest rates,
- management of associated risks,
- policy to be adopted on Minimum Revenue Provision and
- Prudential Indicators for 2015/16 – 2017/18.

Recommendations

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

- policy on debt strategy for 2015/16 to 2017/18 as set out in section 3;
- investment strategy for 2015/16 to 2017/18 and amendments to the credit criteria 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 3.

Contact person for access to background papers and further information:

Name: Graham Perkins
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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, CLG Guidance, CIPFA Prudential Code and CIPFA Treasury Management Code of Practice.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Resources Implications e.g. Staffing/ICT/Assets	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities and these factors have been incorporated into the treasury management systems and procedures which are independently tested on a regular basis. The Council’s in-house treasury management team continually monitor to ensure that the main risks associated with this function of adverse or unforeseen fluctuations in interest rates are avoided and security of capital sums are maintained at all times.
Health & Wellbeing Implications	Not applicable
Health and Safety Implications	Not applicable

Treasury Management Strategy 2015/16 - 2017/18– Summary of Key Points

This report outlines the expected treasury activities for the forthcoming three 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 2)

The global economic recovery which commenced in the second half of 2013, did not continue as forecasted during 2014 with only the UK and US showing any continuing positive signs of growth.

Main economic headlines were:

- UK reported positive growth throughout 2014 with unemployment falling from 2.1m April 2014 (6.6%) to 1.96m September 2014 (6.0%);
- The Eurozone continues to give cause for concern with increasing risk of deflation and weak growth;
- US sustained its recovery despite posting depressed quarter1 growth figures as a result of exceptional bad weather and
- Japan returned negative growth in quarter2 which the Japanese Government is hoping is only a temporary blip.

Debt (Section 3)

In line with previous years practice, no external loans are planned to be taken to finance the Council's capital investment requirement apart from those required for the proposed L.E.D. Street Lighting scheme if this is progressed following the Joint Venture procurement process. As a consequence of this action, the internal borrowing position (i.e. cash backed reserves, balances and cash flow being used rather than taking on new debt) will be at £44.7m by 31 March 2015 and generate a saving in loan interest payable of £1.3m. 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 3)

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 3. *The only recommended change to that previously agreed by Council in February 2014 relates to the Rating Agencies decision to review the Viability and Financial Strength ratings and it is requested that these are removed from the Council's minimum credit criteria.*

The removal of these 2 rating indicators will not affect the creditworthiness of any of the institutions included on the Council's lending list.

Prudential Indicators and limits (Section 7 and Appendix 3)

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 3 for Member approval.

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

1. Background

1.1 The main task of the treasury management function 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. Temporary surplus monies which become available during the year resulting from the receipt of funding ahead of requirement are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity before considering investment return.

1.2 Another function of the treasury management service is to arrange the funding of the Council's capital investment programme. This is longer term cash flow planning to ensure the Council can meet its capital spending obligations and may involve arranging long or short term loans.

1.3 All transactions undertaken as part of the treasury management operation comply with all the statutory requirements together with the CLG Guidance, CIPFA Treasury Management Code of Practice which the Council has adopted and a brief outline of these has been provided at Appendix 1.

1.4 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).

1.5 The Council uses Capita Asset Services as its treasury management advisors who provide a range of services on all treasury matters from the supply of credit ratings to technical support and this service is subject to regular review.

1.6 Whilst the advisors provide support to the internal treasury management team, the Council recognises that the final decision on all treasury management matters remains with the organisation at all times.

1.7 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 and
- Officers will attend courses / seminars presented by CIPFA, LGC, Advisors & any other suitable professional organisation, in accordance with Council policy on this issue.

1.8 Excluded from this report are the activities carried out by the Council's schools, which operate within a 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 The Worldwide economic situation, despite showing signs in late 2013 of recovering, continues to remain in a fragile condition with only the UK and US reporting positive signs of a recovery in 2014.

2.2 Further details on the major economic events which occurred in 2014 and forecasts for 2015/16 are outlined at Appendix 2 for reference.

2.3 Capita, the Council's external treasury management advisors, has produced a set of interest rate forecasts up to March 2018 and these are highlighted in the table below;

Annual Average	Bank Rate (%)	Investment Rates (%)		Borrowing Rates (%)	
		3 month LIBID	1 year LIBID	5 year	25 year
2014/15	0.50	0.50	0.90	2.10	3.35
2015/16	0.63	0.70	1.20	2.40	3.75
2016/17	1.12	1.23	1.70	3.00	4.35
2017/18	1.75	1.83	2.33	3.45	4.70

2.4 The Council's advisors have stated that the economic situation and outlook is uncertain and as a result of this the Council will therefore continue to take a cautious approach to its treasury strategy during this period.

3. Debt Strategy 2015/16 – 2017/18

3.1 The Council has the powers to borrow new funds from either the Public Works Loan Board, part of the Government's Debt Management Office, or from the money market providing it is to assist cash flow in the short term or finance capital investment over the longer term.

3.2 The Council currently maintains an under-borrowed position resulting from the decisions not to finance capital spending from new external loans. Instead cash supporting the Council's reserves, balances and cash flow has been used to finance this requirement and this approach continues to be widely adopted by councils as a result of low investment returns and investment instituion risk.

3.3 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.

	2014/15	2015/16	2016/17	2017/18
	Estimate £000	Estimate £000	Estimate £000	Estimate £000
Debt at 1 April	97,417	94,992	97,922	98,775
Debt maturing	(2,425)	(1,770)	(3,747)	(2,684)
New Debt	0	4,700	4,600	0
Debt at 31 March	94,992	97,922	98,775	96,091
Capital Financing Requirment at 31 March	139,721	138,389	138,325	133,596
Under borrow at 31 March	44,729	40,467	39,550	37,505

3.4 In the current economic climate of investment rates being below long term borrowing rates, the existing strategy of not undertaking any borrowing to replace the funds previously used, totalling £44.7m as at 31 March 2015, is proposed in the main to continue saving the Council £1.3m in loan interest payable (£44.7m x 3.0%).

3.5 It is currently forecasted any new borrowing will only be taken, commencing in 2015/16, regarding the Council's L.E.D. street lighting replacement programme totalling £9.3mif Members approve the implementation of this scheme. These loans will be taken in line with forecasted spend profile for this scheme with all debt costs being met from savings generated from reduced maintenance and energy costs.

3.6 In addition to the borrowing undertaken directly, the Council is also responsible for a further £0.9m which is administered by Tameside Borough Council. This follows the conversion in February 2010 of loans previously held on behalf of Manchester International Airport into an equity rated instrument.

3.7 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.

3.8 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 2015 is provided at Appendix 4 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.

3.11 The Council is required to approve;

- the above debt strategy and
- as part of the Prudential Indicators and Limits requirement, the limits for external debt 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 3 for Council approval.

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 The Council is required, in accordance with C.L.G. regulations, to approve an MRP Policy in advance of each year and for which a variety of options are provided to councils so long as there is a prudent provision. The Council as part of the Prudential Indicators and Limits requirement is requested to approve the MRP statement as detailed at Appendix 3.

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 Council's investment criteria remains as that of previous years i.e. security of capital first, liquidity of its investments and then yield.

5.3 In order to ensure that investments are only placed with strong creditworthy institutions, the Council creates a counterparty list based on credit ratings issued by all three of the main rating agencies (Fitch, Moody's and Standard and Poor's) and uses the lowest common denominator approach which defaults to the lowest equivalent rating. For instance if an institution whose rating issued by one of the credit rating agencies does not meet the minimum criteria stipulated, it will not be included in the approved list of institutions to whom the Council can lend monies to.

5.4 This approach uses real time credit rating information provided by the Council's advisers Capita and enables an institution to be included on this list, using the latest ratings.

5.5 Any institution featuring on the Council's approved list which incurs a negative rating change taking it below the minimum credit criteria required, will immediately be suspended from use and removed from the authorised list.

5.6 Whilst investment risk cannot entirely be eliminated it can be minimised and in order to reduce the risk of an institution defaulting, the Director of Finance has previously recommended the minimum acceptable credit quality for inclusion on the Council's lending list be as follows;

- Short Term – Fitch F1 or equivalent
- Long Term – Fitch A- or equivalent
- Viability / Financial Strength – C (Fitch / Moody's only)
- Support – 3 (Fitch only).

5.7 During the financial crisis, the credit rating agencies provided some institutions with a ratings "uplift" due to implied levels of sovereign support. In response to a recent review of this situation by the agencies, they have announced that these "uplifts" in ratings are now to be removed as a result of sovereign governments moving away from a bail out role. Whilst the actual timing of this change is still currently unknown, it is anticipated that this could occur shortly therefore changes to the credit methodology are required.

5.8 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions; for Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the pending removal of the sovereign support element currently built into each institution assessment, both agencies have suggested that those ratings would duplicate their respective Long Term ratings thereby removing the need for these separate standalone ratings.

5.9 As a result of these pending changes, it is the Council's proposal that the credit criteria will focus solely on the Short and Long Term ratings of an institution at the minimum levels outlined at paragraph 5.6, with Rating Watch's and Outlook information continuing to be assessed where it relates to these categories.

5.10 *It is important to stress that the rating agency amendments do not reflect changes in the underlying status of the institution, merely the removal of that element which has previously been built into the rating for implied Government support. The removal of these 2 elements of credit methodology will not in any way devalue the credit worthiness of any of the institutions the Council uses for the placement of its funds.*

5.11 A full explanation of the credit ratings determining the institutions which the Council will use can be found at Appendix 5.

5.12 The criteria for choosing institutions as set out in more detail at Appendix 3 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 institutions 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 may be restricted.

5.13 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 institution taking into account market opinions, financial press, equity & credit default swap prices. This additional market information is detailed for Members' reference at Appendix 5.

5.14 Further to the Council's list of high quality investment institutions, additional factors will also be used in order to reduce any potential exposure of its investments including how much in total can be placed in non-UK institutions, Groups and Sectors and these are explained in more detail at Appendix 5 together with time and value limits.

5.15 Investments will continue to be placed into three categories as follows;

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period with bank call accounts, money market funds and certificates of deposits being the main methods used for this purpose.
- Medium-term – cash required to manage the annual seasonal cash flow cycle covering the next 12 months and will generally be in the form of fixed term deposits and enhanced money market funds.
- Long-term – cash not required to meet any forthcoming cash flow requirements which can be used primarily to generate investment income by using fixed or structured term deposits, certificates of deposits or government bonds, after taking into consideration the forecasted interest rate yield curve.

5.16 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 3.

5.17 A breakdown of the Council's investments as at 31 December 2014 is provided for reference at Appendix 6.

5.18 The Council is requested to approve;

- the above Investment strategy to be adopted and
- the minimum criteria for providing a list of high quality investment institutions, instruments and limits to be applied are highlighted at Appendix 3.

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 5.

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 institution 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 2015/16 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 Council's treasury management activities as detailed at Appendix 3.

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 2015/16 to 2017/18 as set out in section 3;
- the investment strategy for 2015/16 to 2017/18 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 3.

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 2015/16 to 2017/18, 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 2015
This is a key decision currently on the Forward Plan: Yes

Finance Officer Clearance *……GB…..*

Legal Officer Clearance *… JL..…..*

Director of Finance Signature …………

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 3).

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

CLG. 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.

MAIN ECONOMIC HEADLINES DURING 2014/15

- **UK economy**-
  - Annualised GDP growth of 3.1% was encountered making it the strongest reported rate of growth for any G7 country – this was despite a weakening in the manufactoring sector and exports as a consequence of poor growth in the Eurozone;
  - Consumer Price Index (CPI) fell to 0.5% in December 2014, its lowest level since May 2000;
  - Wage inflation continues to remain significantly below Consumer Price Index Inflation;
  - MPC left both the Bank Rate and Quantative Easing levels unchanged at 0.5% and £375bn respectively;
  - The level of unemployment benefit claimants fell to 6% in September 2014, its lowest in 5 years and remained at this level in October 2014.
- **Eurozone** –
  - Concerns over the economy remain as a result of a downturn in growth, increasing risks of deflation and worries over the Ukraine situation;
  - CPI fell to a low of 0.3% in September 2014 however this is an average for all Eurozone countries and includes some countries with negative rate (deflation);
  - Unemployment rate continues to be a problem at 11.50%;
  - Italy continues to have the third biggest level of debt in the world behind Japan & US;
  - Greece remains vulnerable but continues to make good progress in reducing its annual deficit however this trend is now expected to be modified due to the recent change of government to the anti- austerity party Syriza who wants to renegotiate the terms of its sizeable bailout;
  - European Central Bank reduced its central policy rate from 0.25% to 0.05% and started a programme to purchase corporate debt in September 2014.
- **US** –
  - Despite the first quarter GDP figure being depressed by exceptionally bad winter weather, annualised growth is set to be 2.4%;
  - The Federal Reserve left the Bank rate unchanged at 0.25% and ended its monthly asset purchases (QE) in October 2014 signalling that the economic recovery was on track;
  - Unemployment levels fall to 5.8% in November 2014;
  - CPI 1.30% in November 2014.

Other –

- China's economy appears to be growing by the target rate of 7.5% following the Government's action to stimulate it;
- Japan's economy is giving cause for concern as negative growth in quarter 2 was reported however the Government is hoping that this is a temporary blip.

MAIN ECONOMIC FORECASTS FOR 2015/16

Economic forecasting continues to remain difficult, particularly with many so external influences affecting not only the UK but the Worldwide economy as well and forecasters are currently predicting the following levels of activity;

Indicator	UK	Eurozone	US	China	Japan
Growth Domestic Product	2.7%	1.5%	3.0%	7.1%	1.1%
Consumer Price Index	1.8%	1.1%	2.0%	2.6%	1.6%
Unemployment Rate	5.3%	11.2%	5.9%	7.0%	3.7%
Bank Rate	1.0%	0.1%	2.4%	N/A	0.1%

ELEMENTS FOR COUNCIL APPROVAL (including Prudential and Treasury 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 2015/16 – 2017/18 as detailed below.

PRUDENTIAL AND TREASURY 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	2014/15 estimate £m	2015/16 estimate £m	2016/17 estimate £m	2017/18 estimate £m
(1) Upper Limits – Fixed interest rate exposure (interest costs)	**3.2**	**3.0**	**2.8**	**2.4**
(2) Upper Limits – Variable interest rate exposure (interest costs)	**3.1**	**3.2**	**3.2**	**3.3**
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	6	6	6
Total	**127**	**126**	**126**	**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 Liabilities (PFI)	7	6	6	6
Total	**107**	**106**	**106**	**106**

Prudential Indicators	2014/15 estimate £m	2015/16 estimate £m	2016/17 estimate £m	2017/18 estimate £m
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	**60**	**60**	**60**	**50**
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	6	6	6
Gross debt	107	106	106	106
-C.F.R.	140	138	138	134
Excess C.F.R.	**33**	**32**	**32**	**28**
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 2015/16 to 2017/18		
	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 and treasury 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.

MINIMUM REVENUE PROVISION - (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 CLG 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.
- In instances where the Council incurs borrowing and a third party is obliged to repay the principal (serviced debt arrangements), then the Council will not charge MRP to the revenue account. An example of such an instance can be demonstrated when 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 C.F.R.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.

INVESTMENT CRITERIA – (recommended changes as highlighted)

Counterparty Selection
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 (maximum period 1Year &) and Non-specified investments (maximum period 3 Years);

	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 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 • The use of Viability & Financial Strength ratings are no longer to be applied to the criteria following a review by the Rating Agencies of their relevance. See Para 5.7-5.10 for details	AA- To AAA A- to A+	£20m £5m	3yrs 1yr
Category 2 – UK Banks part nationalised - Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in category1 above.	-	£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	1day
Category 4 – • Money Market Funds – must be AAA credit rated • Enhanced 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 – (no changes)

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 3 including Manchester Airport Shares at 31 March 2014 of £36.7m 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.

Instruments & Maximum period

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

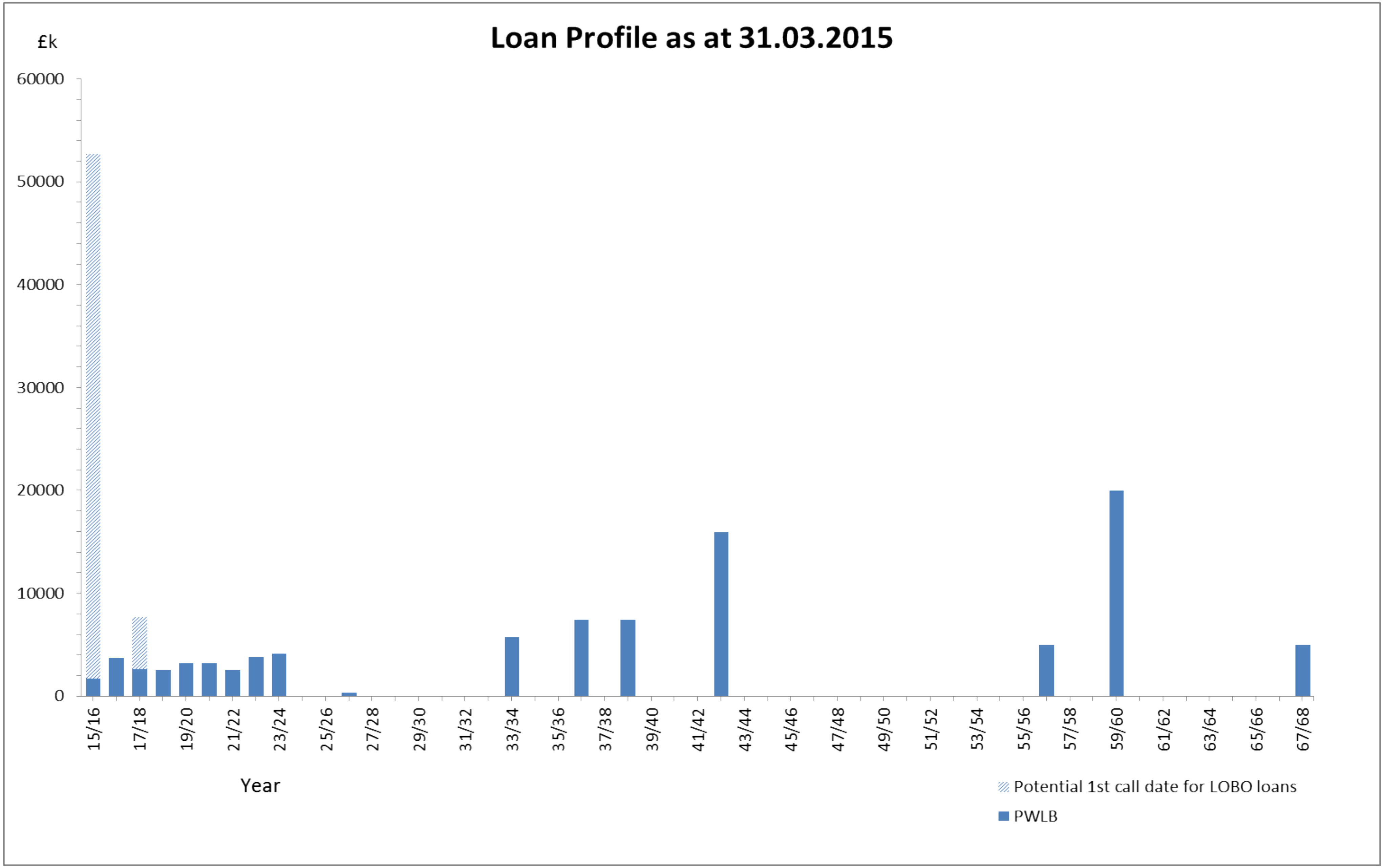
Specified Investments

Investment	Maximum Maturity
The UK Government including Local Authorities and Debt Management Office.	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. In this instance balances will be minimised as far as is possible.	1 Day
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 and Debt Management Office.	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 Airport share-holding which the Council holds at a historical value of £36.7m as reported in the 2013/14 statement of accounts. It is not envisaged that this type of investment will be undertaken in the future.	Unspecified
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


Loan Profile as at 31.03.2015
£k
60000
50000
40000
30000
20000
10000
0
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
67/68
Year
Potential 1st call date for LOBO loans
PWLB

APPENDIX 5

INVESTMENT CREDIT AND INSTITUION RISK MANAGEMENT

The Council receives credit rating advice from its treasury management advisers, as and when ratings change and institutions 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 institution 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 institutions 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**)

Investment Institution information.

Whilst the Council's Investment institutions 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 institution in question is in difficulty.
- Interest rates being paid - If an institution 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 & institutions 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;

- **Country** – this 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;
- **Group** – this will apply where a number of financial institutions are under one ownership (e.g. Royal Bank of Scotland / Nat West) and the Group limit will be the same as the individual limit for any one institution within that group;
- **Sector** limits will be monitored regularly for appropriateness.

Investment Risk benchmarking

Security and liquidity benchmarks are central to the approved treasury strategy through the institution 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 an institution 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 institution 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).

INVESTMENT & EXTERNAL DEBT PORTFOLIO AS AT 31.01.2015

	Principal £m	**Average Rate %**
DEBT		
Fixed rate:		
- PWLB	39.2	6.99
- Market	5.0	4.41
Sub-total	44.2	6.69
Variable rate:		
- PWLB	0.0	0.0
- Market	51.0	5.47
Sub-total	51.0	5.47
Total debt	**95.2**	**6.03**
INVESTMENTS		
- Fixed rate	(40.1)	0.88
- Variable rate	(29.4)	0.49
Total Investments	**(69.5)**	**0.74**
NET ACTUAL DEBT	**25.7**	

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
PFI	Private Finance Initiative – private sector source of funding
PWLB	Public Works Loan Board
VRP	Voluntary Revenue Provision – identical to MRP but on a voluntary basis
WAL	Weighted Average Life – benchmark indicating average life of investments