

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual
Investment Strategy

South Holland District Council

2017/18

Consultation Draft

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1. Introduction

1.1 Background

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

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

“The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The Council's treasury function is undertaken by Compass Point Business Services (East Coast) Ltd (CPBS) on behalf of the Council. CPBS is responsible for:

- Production of the draft annual treasury management strategy
- Production of regular treasury management policy reports
- Production of treasury management practices
- Production of budget and budget variations relating to the treasury management function
- Production of management information reports
- Provision of adequate treasury management resources and skills, and effective division of responsibilities within the treasury management function
- Arrangement of the appointment of external service providers.

1.2 Reporting requirements

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.

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

The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance and Audit Committee.

1.3 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

Capital Issues

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

Treasury Management Issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training is arranged as required.

The training needs of CPBS treasury management officers are periodically reviewed.

1.5 Treasury management consultants

CPBS uses Capita Asset Services as external treasury management advisors for the Council.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2. The Capital Prudential Indicators 2017/18 – 2019/20

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members approve capital expenditure forecasts as part of the annual Budget report.

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

The capital expenditure plans mirror those within the budget report. These have not yet been finalised so the tables below will be completed as part of the final document submitted to Council.

Capital Expenditure £'000's	2015/16 Actual	2016/17 Latest Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total Expenditure	6,420	7,692	13,533	9,226	10,006
Financed by:					
Capital Receipts	101	752	1,300	1,162	1,231
Capital Grants & Contributions	819	863	478	400	400
Major Repairs Reserve	4,411	1,595	1,595	1,595	1,595
Direct Revenue Financing	1,089	3,551	9,040	6,069	6,780
Total Funding	6,420	6,761	12,413	9,226	10,006
Net financing need for the year	0	931	1,120	0	0

The above financing need excludes other long term liabilities, such as Private Financing Initiative (PFI) and leasing arrangements which already include borrowing instruments.

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

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

The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR at present.

As part of the formal governance process, the Council approves the CFR projections which are currently being reworked and will be presented to Council in February.

2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

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

The Council is recommended to approve the following MRP Statement:

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

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

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

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

These options provide for a reduction in the borrowing need over approximately the asset's life.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Repayments included in finance leases are applied as MRP.

Any loans to Welland Homes and South Holland Local Housing Company which are classed as capital expenditure will increase the Council's CFR. The Council will earmark the repayment of the loans to reduce the CFR and therefore will not apply MRP on such loans.

Appropriation of Assets – Where assets do not change ownership and borrowing is not required; the Council will not apply MRP on the asset value transferred.

2.4 Core funds and expected investment balances

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

2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework, prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. As part of the formal governance process, the Council approves the indicators in paragraphs 2.6 to 2.9.

These indicators are currently being examined and will be presented to Council as part of the completed strategy.

2.6 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

The estimates of financing costs will include current commitments and the proposals in the budget report.

2.7 Incremental impact of capital investment decisions on the band D council tax.

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

2.8 Incremental impact of capital investment decisions on housing rent levels.

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

This indicator will show the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

2.9 HRA Ratios

This information will be presented to Council as part of the final strategy.

3. Borrowing

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000's	2015/16 Actual	2016/17 Latest Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt at 1 April	67,456	67,456	67,456	67,456	67,456
Expected change in Debt	0	0	0	0	0
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual gross debt at 31 March	67,456	67,456	67,456	67,456	67,456
The Capital Financing Requirement	69,891	70,822	71,942	71,942	71,942
Under / (over) borrowing	2,435	3,366	4,486	4,486	4,486

Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000's	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	79,360	79,360	79,360	79,360
Other long term liabilities	1,000	1,000	1,000	1,000
Total	80,360	80,360	80,360	80,360

The Authorised Limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt, which while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has never been exercised.
2. As part of the formal governance process, the Council approves the following indicators, as shown below:

Authorised limit £'000's	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	89,456	89,456	89,456	89,456
Other long term liabilities	1,000	1,000	1,000	1,000
Total	90,456	90,456	90,456	90,456

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	74,701	74,701	74,701	74,701

3.3. Prospects for interest rates

Capita Asset Services has been appointed as the Council's treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Capita Asset Services' central view.

	Bank Rate %	PWLB Borrowing Rates% (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Dec 2016	0.25	1.60	2.30	2.90	2.70
Mar 2017	0.25	1.60	2.30	2.90	2.70
Jun 2017	0.25	1.60	2.30	2.90	2.70
Sep 2017	0.25	1.60	2.30	2.90	2.70
Dec 2017	0.25	1.60	2.30	3.00	2.80
Mar 2018	0.25	1.70	2.30	3.00	2.80
Jun 2018	0.25	1.70	2.40	3.00	2.80
Sep 2018	0.25	1.70	2.40	3.10	2.90
Dec 2018	0.25	1.80	2.40	3.10	2.90
Mar 2019	0.25	1.80	2.50	3.20	3.00
Jun 2019	0.50	1.90	2.50	3.20	3.00
Sep 2019	0.50	1.90	2.60	3.30	3.10
Dec 2019	0.75	2.00	2.60	3.30	3.10
Mar 2020	0.75	2.00	2.70	3.40	3.20

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the European Union (EU), it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be

adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and Public Works Loan Board (PWLB) rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Federal Reserve Bank (Fed.) rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
 - Italian constitutional referendum 4.12.16;
 - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
 - Dutch general election 15.3.17;
 - French presidential election April/May 2017;
 - French National Assembly election June 2017;
 - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns

3.4 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

Treasury management limits on activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

As part of the formal governance process, the Council approves the treasury indicators, as follows:

£,000's	2016/17	2017/18	2018/19
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	86,456	86,456	86,456
Limits on variable interest rates based on net debt	8,000	8,000	8,000
Limits on fixed interest rates:			
• <i>Debt only</i>	86,456	86,456	86,456
• <i>Investments only</i>	(35,000)	(35,000)	(35,000)
Limits on variable interest rates:			
• <i>Debt only</i>	8,000	8,000	8,000
• <i>Investments only</i>	(15,000)	(15,000)	(15,000)
Maturity structure of fixed interest rate borrowing 2016/17			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years to 20 years	0%	100%	
20 years to 30 years	0%	100%	
30 years to 40 years	0%	100%	
40 years to 50 years	0%	100%	

Maturity structure of variable interest rate borrowing 2016/17		
	Lower	Upper
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	10%
5 years to 10 years	0%	10%
10 years to 20 years	0%	10%
20 years to 30 years	0%	10%
30 years to 40 years	0%	10%
40 years to 50 years	0%	10%

3.5 Policy on borrowing in advance of need

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

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Cabinet , at the earliest meeting following its action.

3.7 Municipal Bonds Agency

It is likely that the Municipal Bond Agency will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the PWLB. This Authority intends to make use of this new source of borrowing as and when appropriate.

4 Annual Investment Strategy

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

The Council's funds are managed by CPBS with reference to a detailed cash flow forecast on a daily basis for the current year. Protocols are in place to govern the movement of funds within specific limits.

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

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

Investment instruments identified for use in the financial year are listed in **Appendix 2** under the 'specified' and 'non-specified' investments categories. The maximum total investments to any individual financial institution or its parent group is £5m. The maximum limit for individual money market funds is £10m.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark Pink 5 years for Enhanced money market funds with a credit score of 1.25
- Light Pink 5 years for Enhanced money market funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

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

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored daily. CPBS is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings CPBS will be advised of information in movements in CDS spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

4.3 Country limits

The Council has determined that it will only use approved counterparties from the United Kingdom or countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 3**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Investment Strategy

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

Investment returns expectations. Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/ 2017 0.25%
- 2017/ 2018 0.25%
- 2018/ 2019 0.25%
- 2019/2020 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

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

As part of the formal governance process, the Council approves the treasury indicator and limit, as follows:

Maximum principal sums invested > 364 days			
£'000's	2016/17	2017/18	2018/19
Principal sums invested > 364 days	£m 4,000	£m 4,000	£m 4,000

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

4.5 Investment Risk Benchmarking

The Council has not adopted any formal benchmarks in this area, as Officers believe that decisions on counterparties and maximum investment levels are adequate to monitor the current and trend position, and amend the operational strategy to manage risk as conditions change.

4.6 End of year investment report

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

5 APPENDICES

1. Interest rate forecasts 2016-2020
2. Treasury Management Practice 1 – Credit and Counterparty Risk Management
3. Approved countries for investments
4. Treasury management scheme of delegation
5. The treasury management role of the Section 151 Officer

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APPENDIX G

APPENDIX 1 - Interest Rate Forecasts 2016 - 2020

PWLB rates and forecast shown below take account of the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View													
	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%
Bank Rate													
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%	0.75%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%
5yr PWLB Rate													
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	2.00%	2.00%
Capital Economics	1.60%	1.70%	1.80%	1.90%	1.95%	2.05%	2.20%	2.30%	2.40%	2.60%	2.80%	3.20%	3.30%
10yr PWLB Rate													
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%
Capital Economics	2.30%	2.35%	2.45%	2.50%	2.55%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.60%	3.70%
25yr PWLB Rate													
Capita Asset Services	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
Capital Economics	2.90%	3.00%	3.05%	3.10%	3.15%	3.25%	3.30%	3.35%	3.45%	3.55%	3.75%	4.15%	4.35%
50yr PWLB Rate													
Capita Asset Services	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%
Capital Economics	2.80%	2.85%	2.95%	3.00%	3.05%	3.10%	3.15%	3.20%	3.30%	3.50%	3.70%	4.10%	4.20%

APPENDIX 2- Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

	Minimum ‘High’ Credit Criteria	Use
Debt Management Agency Deposit Facility	N/A	In-house
Term deposits – local authorities	N/A	In-house
Term deposits – banks and building societies	Minimum colour of green on our external treasury advisers credit rating matrix	In-house
Certificates of deposit issued by banks and building societies	Minimum colour of green on our external treasury advisers credit rating matrix	In-house
Treasury Bills	UK sovereign rating	In-house
Bonds issued by multilateral development banks	AAA	In-house buy and hold
Money market funds	AAA	In-house (£10m limit for cash flow purposes)

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	Use	Max of total investments	Max. maturity period
UK part nationalised banks	Minimum colour of green on our external treasury advisers credit rating matrix	In-house	£5m	1 year
Banks part nationalised by AAA or AA- sovereign rating countries – non UK	Minimum colour of green on our external treasury advisers credit rating matrix	In-house	£5m	1 year

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of the Accounting Code of Practice.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of £5m will be held in aggregate in non-specified investments.

1. Maturities of ANY Period

	Minimum Credit Criteria	Use	Max % of non-specified investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: -Structured deposits	Sovereign rating of AAA or AA- and minimum colour of green on our external treasury advisers credit rating matrix	In-house	100%	1 year
UK Government Gilts	UK sovereign rating	In-house buy and hold	100%	2 year
Sovereign bond issues (other than the UK govt)	AAA	In-house buy and hold	100%	2 year
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (eg National Rail)	UK sovereign rating	In-house buy and hold	100%	2 year
Collateralised deposits (see note 1)	UK Sovereign rating	In-house	100%	2 year

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -				
	Minimum Credit Criteria	Use	Max % of non-specified investments	Max. maturity period
1. Government Liquidity Funds	Long-term AAA volatility rating MR1+	In-house	100%	5 years
2. Enhanced Money Market Funds with a credit score of 1.25	Long-term AAA volatility rating MR1+	In-house	100%	5 years
3. Enhanced Money Market Funds with a credit score of 1.50	Long-term AAA volatility rating MR1+	In-house	100%	5 years
4. Bond Funds	Long-term AAA volatility rating MR1+	In-house	100%	5 years
5. Gilt Funds	Long-term AAA volatility rating MR1+	In-house	100%	5 years

Note 1. as collateralised deposits are backed by collateral of AAA rated local authority LOBO's, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority.

2. Maturities in excess of 1 year

	Minimum Credit Criteria	Use	Max % of non-specified investments	Max. maturity period
Term deposits – UK local authorities	N/A	In-house	100%	5 year
Loans to: Welland Homes, South Holland Local Housing Company.	Owned by South Holland DC	In-House	£4m £1m	5 year
Term deposits – banks and building societies	Sovereign rating of AAA or AA- and minimum colour of orange on our external treasury advisers credit rating matrix	In-house	100%	5 year
Certificates of deposit issued by banks and building societies	Sovereign rating of AAA or AA- and minimum colour of orange on our external treasury advisers credit rating matrix	In-house	100%	5 year
Bonds issued by multilateral development banks	AAA	In-house	100%	5 year

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Property Funds		In-House	£5m	

The use of property funds can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

Whilst these are maximum limits, under normal circumstances the Section 151 Officer will ensure lower limits are maintained. The higher limits are required to allow flexibility in the movement of funds if a particular issue or circumstance arises e.g. global banking crisis.

The maximum total investment to any individual financial institution or its parent group is £5m and the limit with Money Market Funds is £10m.

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APPENDIX 3 - Approved countries for investments

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar
- U.K.

AA-

- Belgium

APPENDIX 4 - Treasury management scheme of delegation

(i) Full council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.
- approval of / amendments to the council's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities as contained in the Financial Regulations

(ii) Cabinet and Governance & Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- receiving and reviewing the annual strategy and making recommendations to the responsible body.
- receiving and reviewing regular monitoring reports and acting on recommendations.

SCRUTINY AND MONITORING

Council delegates the scrutiny and monitoring of the Treasury Management function to the Governance and Audit Committee. As a minimum they will receive a Mid Term Treasury report on investment issues and performance. Training will be made available for members of the Governance and Audit Committee to ensure they have the necessary skills to undertake this role. Recommendations will be reported to Cabinet.

The Governance and Audit Committee will also have access to professional and independent advice and support as required in order to undertake this role.

APPENDIX 5 - The treasury management role of the Section 151 Officer and deputy

The Section 151 Officer responsibilities are as follows:

- managing the Treasury Management function
 - recommending treasury management policies and practice for approval, reviewing the same regularly and monitoring compliance
 - Ensuring the adequacy of treasury management resources and skills are maintained by CPBS
 - Receiving and reviewing management information reports from CPBS
 - Reviewing the performance of the treasury management function
- Informing Elected members
 - Submitting regular treasury management reports to Members
 - Reviewing the treasury management strategy
 - Maintaining an effective internal audit of treasury management and liaising with external audit.

Compass Point Business Services (CPBS) is responsible for the provision of:

- treasury management strategy statements and practices for approval
- regular treasury management policy reports
- budget and budget variations
- management information reports
- adequate treasury management resources and skills, and effective division of responsibilities within the treasury management function, and;
- arranging the appointment of external treasury management advisors.

Where the use of particular instant access accounts, notice accounts and money market funds has been approved by the Section 151 Officer, CPBS treasury officers have delegated authority to withdraw and deposit funds within the agreed limits contained in this strategy.