

Draft Treasury Management Statement and Annual Investment Strategy 2015/16

1.1 Background

The Authority is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. A key 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 Authority's low risk policy, providing adequate liquidity before considering investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing needs of the Authority, essentially the longer term cash flow planning to ensure that the Authority 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.

Treasury Management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:

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

1.2 Reporting Arrangements

In line with best practice, the Treasury Strategy is considered as part of the budget approval process. This includes the approval of the Prudential and Treasury Indicators.

There are two other main reports each year, which incorporate a variety of policies, estimates and actuals which are approved by Cabinet. These reports are:

- **A Mid - Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and indicate whether the Authority is meeting the strategy or whether any policies require revision; and
- **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.

1.3 Treasury Management Strategy for 2015/16

The proposed strategy for 2015/16 in respect of the following aspects of the treasury management function is based upon the treasury management officers' view on interest rates, supplemented with market forecasts provided by the Authority's treasury advisor, Capita Asset Services. This strategy covers:

- The current treasury portfolio position;
- Prospects for interest rates;
- Economic Outlook;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- Annual investment strategy;
- Creditworthiness; and,
- Policy for the use of external service providers.

1.4 Current Treasury Portfolio Position

The Authority's debt and investment position at 5 November 2014 is set down in Table 1 below. This has been compared with the comparable position as at 7 November 2013.

Table 1: Current Treasury Portfolio Position as at 5 November 2014

	Principal Outstanding	Average Rate	Principal Outstanding	Average Rate
	(05 Nov 2014)	%	(07 Nov 2013)	%
	£m		£m	
Fixed Rate Funding				
PWLB*	235.650	5.82	264.750	5.70
PWLB – (HRA Self Financing)	128.193	3.49	128.193	3.49
Market Loans	20.000	4.35	20.000	4.35
Temp Loans	35.854	0.63	28.173	0.54
Total External Debt	419.697		441.116	
<i>Less Investments (UK) DMO**</i>	4.400	0.25	14.900	0.25
Total Investments	4.400		14.900	
Net Position	415.297		426.216	

*Public Works Loan Board

**Debt Management Office

1.5 Prospects for Interest Rates

The Authority has appointed Capita Asset Services as its external treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Table 2 below sets out Capita Asset Services professional view of forecast interest rates.

Table 2: Capita Asset Services forecast interest rates – 5 November 2014

	Bank Rate %	5 year PWLB %	25 year PWLB %	50 year PWLB %
Dec 2014	0.50	2.50	3.90	3.90
Mar 2015	0.50	2.70	4.00	4.00
Jun 2015	0.75	2.70	4.10	4.10
Sep 2015	0.75	2.80	4.30	4.30
Dec 2015	1.00	2.90	4.40	4.40
Mar 2016	1.00	3.00	4.50	4.50
Jun 2016	1.25	3.10	4.60	4.60
Sep 2016	1.25	3.20	4.70	4.70
Dec 2016	1.50	3.30	4.70	4.70
Mar 2017	1.50	3.40	4.80	4.80
Jun 2017	1.75	3.50	4.80	4.80
Sep 2017	2.00	3.50	4.90	4.90
Dec 2017	2.25	3.50	4.90	4.90
Mar 2018	2.50	3.50	5.00	5.00

1.6 Economic Outlook

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

- Concerns that the Eurozone is heading for a triple dip recession for the first time since 2008; Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond;
- Borrowing interest rates have been volatile during 2014 as alternating aspects of good and bad news have promoted optimism, and then pessimism, in financial markets. The policy of avoiding new borrowing by running down 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 new capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any borrowing undertaken that results in an increase in investments and will incur a revenue loss between borrowing costs and investment returns.

1.7 Borrowing Strategy

The Authority's capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Authority'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 relatively high.

The Authority's borrowing strategy will give consideration to new borrowing in the following order of priority:

- The cheapest borrowing and lowest risk approach is internal borrowing. By continuing to maintain a relatively low level of cash balances the risk of investment is reduced and the historically low rates of interest means that the interest foregone is lower than in previous years. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.
- Temporary borrowing from the money markets or other local authorities.
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt.
- PWLB borrowing for periods of longer than 10 years may be explored.

The principal risks that impact on the strategy are the security of the Authority's investments and the potential for sharp changes to long and short term interest rates. Officers, in conjunction with the Authority's treasury advisor, will continue to monitor the financial standing of banks and building societies on the counterparty list, and the level of interest rates, both those prevailing and forecast.

Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet or full Council, as appropriate, at the next available opportunity. Such circumstances include a situation where:

- If it were felt that there was a significant risk of a sharp fall in long and short term interest rates, perhaps due to marked increases 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 funding will be considered; or

- If it were felt there was a significant risk of a sharp rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risk, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

1.8 Policy on borrowing in advance of need

The Authority 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 Authority can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Authority will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- Consider the merits and demerits of alternative forms of funding;
- Consider the alternative interest rate bases available, the most appropriate periods to fund the repayment profiles to use; and,
- Consider the impact of borrowing in advance temporarily increasing investment cash balances and the consequent increase in exposure of counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

1.9 Debt Rescheduling

As short term borrowing rates are expected to be considerably cheaper than longer term 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 size of the premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature,

compared to the current rates of longer term debt in the existing debt portfolio. Any position taken via rescheduling will be in accordance with the strategy position outlined above.

In order to generate the most attractive debt rescheduling opportunities, it is proposed that the strategy for 2015/16 should remain flexible. The reason for any rescheduling to take place may include:

- the generation of cash savings at minimum risk;
- to help fulfil the strategy outlined above; and
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

All rescheduling will be reported to Cabinet as part of the next financial management report at the meeting following its action.

1.10 Annual Investment Strategy

This Authority has regard to the Communities and Local Government's (CLG's) Guidance on Local Government Investments and the 2011 revised Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Authority's investment priorities are:

- a) the security of capital;
- b) the liquidity of its investments; and,
- c) return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Authority has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. Creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by credit rating agencies. Potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Treasury officers 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 the financial sector on both a micro and macro basis and in relation to the economic environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Authority will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources will include the financial press, share prices 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.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The investment strategy states which instruments the Authority may use for investment purposes. This is set out in Appendix D of the report to Cabinet of the 24 November 2014.

The intention of the strategy is to provide security of investments and minimisation of risk.

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).

The Bank Rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 2 of 2015. Table 3 below sets out Bank Rate forecasts for financial year ends (March) as follows:

Table 3: Bank Rate Forecast for Financial Year Ends

Year End (March)	Bank Rate Forecast (%)
2015/16	1.00
2016/17	1.50
2017/18	2.50

There is a downside risk to these forecasts (i.e. the start of increases in the Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

The strategy for 2014/15 agreed on 19 February 2014 was set in a background of uncertainty and a prudent approach was taken with nearly all investments being made on an overnight basis. In the current economic climate it is essential that a prudent approach is maintained. This will primarily be achieved through investing with selected banks and funds which meet the Authority's credit rating criteria, set out in Appendix D of the report to Cabinet of the 24 November 2014.

The Authority will avoid locking into longer term deals while investment rates are down at low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the full Council.

It is also important to recognise that movements within the money markets can happen with no notice and the Chief Finance Officer may have to amend this strategy in order to safeguard the funds of the Authority. Any such actions will be reported to Cabinet as part of the next financial management report at the meeting following this action.

The Chief Finance Officer will undertake the most appropriate form and duration of investments depending on the prevailing interest rate at the time, taking into account the risks shown in the interest rate forecast.

All investments will be made in accordance with the Authority's investment policies and prevailing legislation and regulations.

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

1.11 Creditworthiness

Credit ratings will continue to be monitored by the Authority's treasury management team. The Authority is alerted to changes to ratings through its use of the Capita Asset Services creditworthiness service who notify the Authority of any changes as soon as they receive the information. This creditworthiness service uses a modelling approach with credit ratings from the three main rating agencies – Fitch, Moody's and Standard and Poor's, forming the core element. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system. Where an institution has its credit rating downgraded so that it fails to meet the Authority's credit criteria then:

- no new investments will be made after the date of notification, and,
- investments on call will be recalled immediately.

Where an institution is placed on negative rating watch (notification of a possible rating downgrade) deposits will continue to be made up to approved limits so long as the institution's credit quality is above the Authority's minimum criteria.

Sole reliance will not be placed on the use of this external service. In addition this Authority will also use market data and market information, information on government support for banks and the credit ratings of the government support.

1.12 Policy on the use of external service providers

The Authority uses Capita Asset Services as its external treasury management advisor.

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

The Authority 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 Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subject to regular review.