Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

South Holland District Council

2016/17

INDEX

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 2016/17

The strategy for 2016/17 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 2016/17 – 2018/19

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.

Capital Expenditure £'000's	2014/15 Actual	2015/16 Latest Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
General Fund	2,863	2,455	3,933	1,567	1,491
HRA	5,815	5,446	7,179	7,684	7,735
Total	**8,678**	**7,901**	**11,112**	**9,251**	**9,226**

The table below summarises the above 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).

Capital Expenditure £'000's	**2014/15 Actual**	**2015/16 Latest Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund	2,863	2,455	3,933	1,567	1,491
HRA	5,815	5,446	7,179	7,684	7,735
Total Spend	**8,678**	**7,901**	**11,112**	**9,251**	**9,226**
Financed by:					
Capital receipts	20	837	873	1,300	1,162
Capital grants & contributions	913	1,145	725	400	400
Direct Revenue Funding /Use of Reserves	6,238	5,769	7,463	7,551	7,664
Total Financing	**7,171**	**7,751**	**9,061**	**9,251**	**9,226**
Net financing need for the year	**1,507**	**150**	**2,051**	**0**	**0**

NB: Financing need reflects planned loans to Welland Homes Limited in 2015/16 & 2016/17.

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, as follows:

£’000’s	2014/15 Actual	2015/16 Latest Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Financing Requirement					
CFR - non HRA	2,211	458	3,026	3,026	3,026
CFR - HRA	69,606	69,606	69,089	69,089	69,089
Total CFR	**71,817**	**70,064**	**72,115**	**72,115**	**72,115**
Movement in CFR	**1,423**	**(1,753)**	**2,051**	**0**	**0**
Movement in CFR represented by					
Net financing need for the year (above)	1,507	150	2,051	0	0
Less MRP and other financing movements	(84)	(1,903)	0	0	0
Appropriations - GF			517		
Appropriations - HRA			(517)		
Movement in CFR	**1,423**	**(1,753)**	**(2,051)**	**0**	**0**

Note the MRP includes finance lease annual principal payments.

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 Council to approve **a 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 Councils 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.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £'000's	**2014/15 Actual**	**2015/16 Latest Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
General Fund Balance	2,055	2,023	2,023	2,023	2,023
HRA Working Balance	8,968	11,577	11,577	11,577	11,577
Earmarked Reserves	9,474	7,030	6,487	6,503	6,362
Capital Grants Unapplied	1,522	1,497	1,372	1,297	1,222
Capital receipts	1,907	1,592	1,325	631	74
Total core funds	**23,926**	**23,719**	**22,784**	**22,031**	**21,258**
Working capital*	3,878	3,878	3,878	3,878	3,878
Under borrowing	-4,348	-2,608	-4,659	-4,659	-4,659
Expected investments	**23,456**	**24,989**	**22,003**	**21,250**	**20,477**

*Working capital balances shown are estimated year end; these may be higher mid year.

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 following indicators:

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.

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Non-HRA	-0.28%	0.50%	-1.79%	-2.16%	-2.62%
HRA	22.83%	22.32%	23.73%	23.97%	24.22%

The estimates of financing costs include current commitments and the proposals in this 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.

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Council tax - band D	-£9.26	£7.92	£0.37	£0.61	£0.87

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.

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Weekly housing rent levels	£0.21	£0.24	£0.00	£0.00	£0.00

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

2.9 HRA Ratios

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
HRA debt £m	67	67	67	67	67
HRA revenues £m	17	17	16	16	16
Ratio of debt to revenues (%)	401	386	411	416	421

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
HRA debt £m	67	67	67	67	67
Number of HRA dwellings	3,888	3,879	3,847	3,847	3,850
Debt per dwelling (£)	17,350	17,390	17,535	17,537	17,521

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 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 2015, 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	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External Debt					
Debt at 1 April	67,493	67,469	67,456	67,456	67,456
Expected change in Debt	(3)	0	0	0	0
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	(21)	(13)	0	0	0
Gross debt at 31 March	**67,469**	**67,456**	**67,456**	**67,456**	**67,456**
CFR	71,817	70,064	72,115	72,115	72,115
Under / (over) borrowing	**4,348**	**2,608**	**4,659**	**4,659**	**4,659**

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 2016/17 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 for external debt in normal circumstances, which includes the CFR and the borrowing capacity of the HRA. This indicator will be subject to continuous review in respect of Housing activities particularly with regard to Welland Homes projects.

Operational boundary £'000's	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
Debt	70,064	79,360	79,360	79,360
Other long term liabilities	1,000	1,000	1,000	1,000
Total	71,064	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 fixed limit approved by the Council. It reflects a level of external debt, which the council is able to service in the short term, but not 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.
2. As part of the formal governance process, the Council approves the following indicators, as shown below:

Authorised limit £'000's	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 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	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 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. **Appendix 1** draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita Asset Services' central view:

Annual Average %	Bank Rate %	PWLB Borrowing Rates% (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Mar 2016	0.50	2.00	2.60	3.40	3.20
Jun 2016	0.50	2.10	2.70	3.40	3.20
Sep 2016	0.50	2.20	2.80	3.50	3.30
Dec 2016	0.75	2.30	3.90	3.60	3.40
Mar 2017	0.75	2.40	3.00	3.70	3.50
Jun 2017	1.00	2.50	3.10	3.70	3.60
Sep 2017	1.00	2.60	3.20	3.80	3.70
Dec 2017	1.25	2.70	3.30	3.90	3.80
Mar 2018	1.25	2.80	3.40	4.00	3.90
Jun 2018	1.50	2.90	3.50	4.00	3.90
Sep 2018	1.50	3.00	3.60	4.10	4.00
Dec 2018	1.75	3.10	3.60	4.10	4.00
Mar 2019	1.75	3.20	3.70	4.10	4.00

UK. UK Gross Domestic Product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that Consumer Price Index (CPI) inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK.

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase. However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick-up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

EZ. In the Eurozone (EZ), the European Central Bank (ECB) unleashed a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when 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 new borrowing which causes an increase in investments as this will incur a revenue loss 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 relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

Discussions are in progress with the UK Municipal Bonds Agency to establish links for potential external borrowing as and when it becomes necessary.

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

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

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: • ***Debt only*** • ***Investments only***	86,456 (35,000)	86,456 (35,000)	86,456 (35,000)
Limits on variable interest rates: • ***Debt only*** • ***Investments only***	8,000 (15,000)	8,000 (15,000)	8,000 (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, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

4 Annual Investment Strategy

4.1 Introduction: changes to credit rating methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA-. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the “support” phase of the financial crisis.

4.2 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” 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.

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

Investment instruments identified for use in the financial year are listed in **Appendix 3** under the ‘specified’ and ‘non-specified’ investments categories. The maximum total investments to any individual financial institution or its parent group is £5m. There is also a limit of £5m for investments with part-nationalised banks.

4.3 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utlilising 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.

4.4 Country limits

Due care will be taken to consider the country, group and sector exposure of the Council's investments.

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 4**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.5 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 remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2016/ 2017 0.75%
- 2017/ 2018 1.25%
- 2018/ 2019 1.75%

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	0.60%
2017/18	1.25%
2018/19	1.75%
2019/20	2.25%

The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

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.

4.6 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.

4.7 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
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

APPENDIX 1 - Interest Rate Forecasts 2016 - 2019

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													
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%
6 Month LIBID	0.70%	0.70%	0.80%	0.90%	1.00%	1.20%	1.30%	1.50%	1.60%	1.70%	1.80%	2.00%	2.20%
12 Month LIBID	1.00%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.80%	1.90%	2.00%	2.10%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB Rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB Rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
Capital Economics	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
Capital Economics	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Capital Economics	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

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 (£5m 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 (e.g. 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 LOBOs, 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 % or £ 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 Community 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.

APPENDIX 3 - Approved countries for investments

AAA

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

AA+

- Finland
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar

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.