BARNSLEY METROPOLITAN BOROUGH COUNCIL

This matter is a key decision within the Council's definition and has been included within the relevant Forward Plan

Report Ref:

Cabinet: 11 February 2014

Report of the Director of Finance, Property and Information Services

TREASURY POLICY AND STRATEGY STATEMENTS 2015/16

1. Purpose of Report

1.1 The purpose of this report is to present for approval the 2015/16 Treasury Policy Statement and Treasury Strategy Statement, including the Annual Investment Strategy.

2. Recommendations

2.1 It is recommended that: -

- **Members note the main treasury management policies, as outlined in the Treasury Policy Statement (Annex A).**
- **Members approve the attached Treasury Strategy Statement for 2015/16 (Annex B) including:-**
  - the Minimum Revenue Provision (MRP) Statement at Appendix E.
  - the Annual Investment Strategy for 2015/16.

3. Background

3.1 The Treasury Management Code of Practice requires local authorities to produce a Treasury Management Strategy and Policy Statement on an annual basis.

3.2 The Council adopted the original CIPFA Code of Practice on 13th February 2002, and this resolution is carried through to the revised Code. Therefore, the attached Treasury Policy Statement and Treasury Strategy Statements for 2015/16 have been prepared in compliance with the revised Code.

4. Treasury Policy Statement

4.1 Attached at Annex A is the Council's Treasury Policy Statement (TPS) for 2015/16. This complies with the requirements of the Code and is submitted for approval.

4.2 The TPS defines the Council's polices, objectives and approach to risk management of its treasury management activities. Further detail is contained within the Council's Treasury Management Practices (TMPs) document. This is the key systems document for the Council and the Executive Director of Finance, Property and Information Services in the operation, review and performance assessment of the Treasury Management function.

4.3 The revised code recommends the TPS should include the organisation's high level policies for borrowing and investments and these requirements are addressed within the 2015/16 document.

5. Treasury Strategy Statement

5.1 Attached at Annex B is the Council's Treasury Strategy Statement (TSS) for 2015/16. This Statement details:

- Outlook for interest rates
- Borrowing requirements & strategy
- Annual investment strategy
- Approach to risk management
- Minimum Revenue Provision statement for 2015/16

5.2 The Authority's treasury management advisor Arlingclose forecasts the first rise in official interest rates in August 2015 and gradual increases thereafter, with the average for 2015/16 being around 0.75%. The TSS is based on this interest rate forecast and close monitoring of rates will continue throughout the year.

5.3 The Council has developed General Fund and Housing Revenue Account borrowing strategies in response to the changes following the implementation of housing self-financing.

5.4 The Council's borrowing strategy will continue to focus on interest costs in order to minimise the impact on the overall revenue budget however it will also seek to address the GF interest rate risk exposure and refinancing risk. The approach will consider a range of options to address these aims including:

- Continuing the process of internal borrowing
- Continuing temporary/short-term borrowing from other local authorities
- A phased progamme of long-term borrowing aimed at reducing interest rate risk and refinancing risk especially for future borrowing
- Taking fixed rate debt to cover maturities, generating guaranteed savings
- Restructuring/rescheduling existing debt.

The potential combination of the above approaches should help to keep interest payments at relatively low levels, whilst gradually reducing the General Fund's exposure to interest rate and refinancing risk.

5.5 The key aim of the HRA borrowing strategy is to manage the affordability of debt repayments within the 30 year business plan. There is a limited borrowing requirement in 2015/16 and therefore the initial strategy will be to internally borrow.

5.6 The TSS outlines the Council's Minimum Revenue Provision (MRP) statement for 2015/16. The Council will apply Option 1 (Regulatory Method) in respect of supported capital expenditure and Option 3 (Asset Life) in respect of unsupported capital expenditure. Within Option 3 revenue provision is calculated in one of two ways – equal instalments or annuity method. Each capital project will be individually assessed to determine the most appropriate method of calculation.

5.7 MRP will normally commence in the financial year following the one in which expenditure is incurred, however revised MRP Guidance allows authorities to defer MRP until the financial year following the one in which the asset becomes ***operational***. Again, the Council will assess each scheme on an individual basis.

6. Annual Investment Strategy

6.1 In compliance with CLG Guidance the Council's investment priorities are security, liquidity and then yield.

6.2 As a result of the Council's strategy of internal borrowing, investment balances will remain depleted. This approach, combined with low money market rates will reduce the level of investment income.

6.3 The Code requires authorities to analyse information over and above credit ratings including share price and Credit Default Swaps (CDS). In tandem with Arlinglcose, the Council will continue to monitor these revised indicators of creditworthiness.

6.4 The 2015/16 investment strategy has been developed to take into account of continuing uncertainty within financial markets and recent changes to the regulatory framework. The *Bank Recovery and Resolution Directive* and the *Deposit Guarantee Schemes Directive* will leave public authorities likely to incur losses in a failing bank after July 2015. Due to these legislative changes, the credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Authority. This has resulted in some significant changes to our approach to the investment of funds which are detailed within the strategy.

7. Consultations

7.1 The Treasury Policy and Strategy Statements were drafted in consultation with the Council's Treasury Management advisors (Arlingclose).

8. Risk Implications

8.1 The successful identification, monitoring and control of risk is an important and integral element of its treasury management activity.

8.2 Credit, interest rate and refinancing risk are the most relevant to the Council at the current time. The following 2015/16 TMSS and TPS sets out how the Council intends to address these risks. An additional Appendix has also been included (Appendix B) within the TMSS which further examines the risks faced by the Council and the mitigations used to address these risks.

8.3 In order to implement the strategy and monitor treasury management activity, the Council has set up a Treasury Management (TM) Panel. Chaired by the Director of Finance, Property and Information Services and including the Cabinet and Deputy Cabinet spokespersons for Finance, Property and Information Services, the TM Panel meets on a quarterly basis to ensure that the approved treasury strategy is implemented.

8.4 To further enhance the scrutiny and risk management of the treasury management operation, treasury officers have been working closely with members of the Audit Committee.

9. Reduction of Crime and Disorder

9.1 None arising directly from this report.

10. Employee Implications

10.1 None arising directly from this report.

11. Financial Implications

11.1 The strategy outlines borrowing and investment activity which will be factored into the wider budget.

12. Annexes

12.1 Annex A Treasury Policy Statement 2015/16
Annex B Treasury Strategy Statement 2015/16

13. Background Papers

13.1 The following documents and publications were used in preparation of the Treasury Management documents :

- CIPFA's Treasury Management Code of Practice
- CIPFA's Prudential Code for Capital Finance in Local Authorities.
- CIPFA's guide to Housing Self Financing.
- Papers from the Council's Treasury Management advisors (Arlingclose).

Office Contact: Frances Foster Tel: 3163 Date:

Annex A

TREASURY POLICY STATEMENT

2015/2016

1 Introduction & Background

1.1 The Treasury Management Code of Practice requires local authorities to produce a Treasury Management Strategy and Policy Statement on an annual basis.

1.2 The Council adopted the original CIPFA Code of Practice on 13th February 2002, and this resolution is carried through to the revised Code. Therefore, the Treasury Policy Statement for 2015/16 has been prepared in compliance with the revised Code.

1.3 Accordingly, the Council will create and maintain the following key documents in accordance with the revised Code of Practice and other relevant guidance:

- Treasury Management Policy Statement, outlining the key objectives of its treasury management activities;
- Treasury Management Strategy Statement including the Annual Investment Strategy setting out the specific expected treasury activities for the forthcoming financial year;
- Treasury Management Practices (TMP) setting out the manner in which the Council will seek to achieve its objectives, and prescribing how it will manage and control those activities;
- Treasury Management Prudential Indicators as prescribed within the Prudential and Treasury Management Codes.

1.4 The Council will receive reports on its treasury management activities, including as a minimum, an annual strategy for the forthcoming year, an annual report after year end and interim quarterly reports.

1.5 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Full Council, and for the execution and administration of treasury management decisions to the Director of Finance, Property and Information Services, who will act in accordance with the Council's Policy Statement and the CIPFA Code of Practice.

1.6 The Council nominates the Treasury Management Panel and the Audit Committee as being responsible for ensuring the effective scrutiny of the treasury management strategy and policies.

1.7 The Treasury Management Panel will meet on a quarterly basis to monitor and review the Councils implementation of the Treasury Management Strategy and Policy. The Audit Committee will receive reports through which it will gain assurance regarding the effective implementation of the Strategy and Policy.

1.8 The Treasury Management function will be subjected to an independent internal audit review on annual basis as a designated core system and subject to external audit inspection as part of the final accounts review.

2. Policies and Objectives of Treasury Management Activities

2.1 The Council defines its treasury management activities as:

"the management of the organisation'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."

2.2 Approved activities of the Treasury Management operation cover:

- borrowing;
- lending;
- debt repayment and rescheduling;
- consideration, approval and use of new financial instruments and treasury management techniques;
- managing cash flow;
- banking activities;
- leasing
- managing the risk associated with the Council's treasury management activities

2.3 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will include their risk implications for the organisation.

2.4 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.5 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The Director of Finance, Property and Information Services has delegated powers to select the most appropriate form of capital financing (including leasing arrangements) from the approved sources. The source from which the borrowing is taken and type of borrowing should allow the Council transparency and control over its debt.

2.6 The Council's primary objective in relation to investment remains the security of capital. The liquidity of the Council's investments and the yield earned remain important but secondary considerations.

2.7 The Annual Investment Strategy details the categories of investment the Council will invest in, maturity periods and criteria for selecting investment counterparties. Any revisions to these criteria will require Council approval.

Annex B

TREASURY MANAGEMENT STRATEGY STATEMENT 2015/16

Contents

1. Background

1.1 The Council is required to produce a Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also incorporates the Annual Investment Strategy (AIS). Together, these cover the financing and investment strategy for the forthcoming financial year. The PIs for 2014/15 to 2017/18 are included at Appendix C.

1.2 The Council is responsible for its treasury decisions and activity. The successful identification, monitoring and control of treasury management risks are integral to treasury management activity. The following 2015/16 TMSS sets out how the Council intends to address the most significant risks and a schedule is included at Appendix A.

1.3 In order to implement the strategy and monitor treasury management activity, the Council has set up a Treasury Management Panel. Chaired by the Executive Director of Finance, Property & Information Services and including the Cabinet and Deputy Cabinet spokespersons for Finance and Property Services, the TM Panel meets on a regular basis to ensure that the approved treasury strategy is implemented.

2. Outlook for Interest Rates

2.1 There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is currently extremely benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

2.2 The focus of the Monetary Policy Committee (MPC) is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for an 0.25% increase in rates at each of the meetings between August and December 2014, the minutes of the January 2015 meeting showed unanimity in maintaining the Bank Rate at 0.5% as there was sufficient risk that low inflation could become entrenched and the MPC became more concerned about the economic outlook.

2.3 Despite the split in votes, the official bank rate has remained at 0.5% throughout 2014/15 and is unchanged since 2009. Arlingclose, the Council's treasury advisors, forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%.

2.4 Financial markets remained nervous throughout the year due to ongoing events and a number of new developments. In addition to continued uncertainties over the conflicts in Ukraine and the Middle East, mounting conviction that the US Federal Reserve could bring forward its first hike in official interest rates did not help the mood of the financial markets across the globe.

2.5 The Eurozone recovery faltered in the second quarter of the year, with contraction in Germany and stagnation in France. Uncertainty was amplified by discord within the French government which prompted a cabinet reshuffle in August. With Italy back in recession and activity in Germany weakening, hopes of a positive growth path are fading. These developments, coupled with the persistent weakness of inflation have strengthened hopes that the European Central Bank (ECB) will finally resort to more aggressive monetary policy easing to kick start the economy.

2.6 Looking ahead to 2015/16, the outcome of the Greek elections in January 2015 could have a significant impact on the Eurozone economy. The Syriza party won the election and an anti-austerity cabinet has been formed by new Prime Minister Alexis Tsipras. The first order of business was to pause privatisation plans that were to be used to raise capital to pay down debt. An abandonment of the enforced austerity measures will have ramifications for other 'bailed-out' nations and for the economic outlook of the Eurozone as a whole. The worst-case scenario, albeit remote right now, is a complete breakdown if Greece defaults, fails to come to an agreement with its creditors and ends up exiting the Eurozone. The situation will be monitored closely by treasury staff in terms of potential impact on the Authority's investments.

2.7 The transposition of two European Union directives into UK legislation in the coming months will place burden on rescuing failing EU banks disproportionately onto unsecured local authority investors. The *Bank Recovery and Resolution Directive* promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes.

2.8 The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015. The Credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Authority.

2.9 In terms of borrowing, Arlingclose projects gilt yields on an upward path in the medium term, taking the forecast average 10 year PWLB loan rate for 2015/16 to 2.70%. Currently the risk to this forecast is on the downside – i.e. it is more likely that rates will prove to be lower than this central case forecast than higher. Given the Council's (specifically the General Fund's) ongoing borrowing requirement and existing exposure to interest rate movements (see 4.2), the forecasting and monitoring of borrowing rates and the associated management of risk is a key issue for 2015/16. The following strategy outlines how the Council intends to manage this risk.

2.10 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

3. Debt Split – Two Pool Approach

Background

3.1 Following the reform of the HRA Subsidy system, the Council adopted the two-pool approach to debt management, maintaining separate pools for the General Fund (GF) and Housing Revenue Account (HRA).

3.2 Maintaining two pools in theory allows decisions on the structure and timing of borrowing to be made independently. Whilst the key issue facing the GF is one of short-term affordability, the HRA has to consider treasury management as a key risk against the viability of the 30 year business plan.

3.3 To address these differing requirements borrowing strategies for both the HRA and GF have been produced.

GF Borrowing Requirement

3.4 The Council's underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision (MRP) for repaying debt from within the revenue budget each year.

3.5 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR and in turn produce an increased requirement to charge MRP in the revenue account. A separate statement on the Council's policy on MRP is shown at Appendix E.

3.6 The GF's estimated CFR is shown below:

	Estimate 2014/15	**Year 1 2015/16 Estimate**	**Year 2 2016/17 Estimate**	**Year 3 2017/18 Estimate**
	£M	**£M**	**£M**	**£M**
Capital Financing Requirement (CFR)	633	642	630	615
Less: Other Long Term Liabilities	238	231	235	227
Borrowing CFR	**395**	**411**	**395**	**388**
Less : Existing Profile of Borrowing	283	281	276	270
Cumulative Maximum External Borrowing Requirement	112	130	119	118
Usable Reserves	99	99	99	99
Cumulative Net Borrowing Requirement	**13**	**31**	**20**	**19**

3.7 The GF has a significant ongoing borrowing requirement as shown in the table above. This is as a result of the strategy of internal rather than external borrowing to fund major capital schemes such as the Building Schools for the Future Programme and the markets and town centre development.

3.8 Given the GF's forecast CFR position as at 31/3/2015, it is anticipated there will be a further external borrowing need in the current financial year as the level of un-funded CFR exceeds the available balances and reserves, illustrated by the net cumulative borrowing requirement of £13M.

3.9 This position is subject to change as factors such as capital slippage, working capital and the level of investments will all impact on the borrowing requirement. Officers will monitor the Council's cash position to ensure sufficient liquidity is maintained.

4 <u>The Council's Borrowing Strategy (GF)</u>

Aim

4.1 Given the significant cuts to local government funding, the GF's borrowing strategy seeks to address the key issue of affordability whilst managing the interest rate risk and refinancing risk contained within the debt portfolio.

Interest Rate Risk

4.2 As stated at 3.2, the risk profile of the GF has altered significantly following the apportionment of debt resulting from the implementation of self-financing. The GF loan pool is now subject to a much greater degree of interest rate risk, as shown below (estimated at 31.3.15):

Borrowing method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB - fixed	154	39	No
Market Fixed *	27	7	No
PWLB – variable	35	9	Yes
Temporary Borrowing	67	17	Yes
Internal Borrowing / Borrowing Requirement	112	28	Yes
TOTAL	**395**	**100**	

Note – although market loans are viewed as fixed rate borrowing, there is a potential interest rate risk attached to these instruments should the lender exercise the call option.

4.3 Assuming an estimated borrowing CFR of £395M (CFR less long-term liabilities) at the end of 2014/15, 54% (£214M) of the GF loan pool is exposed to short-term interest rate movements and in the case of temporary borrowing, refinancing risk.

4.4 Exposure to variable interest costs will be offset to some extent by maintaining a level of variable rate investments. Assuming investments of £40M, net interest rate exposure is reduced from 54% to 44%.

4.5 However, it may be more beneficial to examine interest rate exposure in the context of a 'liability benchmark'. It is highly unlikely the Council would borrow up to the CFR and externalise all internal borrowing in the short to medium term. The use of a 'liability benchmark' attempts to give a more realistic value to the borrowing requirement and in essence represents a level of debt required to keep investments at a minimum liquidity level.

4.6 Assuming a 'liability benchmark', i.e. a total projected borrowing requirement, of £325M, the interest rate exposure can be recalculated as follows:

Borrowing method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB – fixed	154	48	No
Market Fixed	27	8	No
PWLB – variable	35	11	Yes
Temporary Borrowing	67	20	Yes
Internal Borrowing / Borrowing Requirement	42	13	Yes
TOTAL	**325**	**100**	

4.7 Using the liability benchmark reduces interest rate exposure to 44% represents a more realistic picture.

4.8 Retaining a relatively high level of exposure has clear benefits in reduced interest costs. The GF's share of existing PWLB variable rate loans (£35M) continues to represent excellent value with an interest rate of 0.70% and the average rate payable on temporary borrowing is 0.61% (Dec 14).

4.9 It is important to view the interest rate risk against the cost of shutting that risk down. For example, the rate on the £67M of temporary borrowing is calculated at 0.61% in Dec 2014. A 5 year and 10 year fixed rate PWLB loan would cost 2.48% or 3.15% (Dec 2014) respectively. If the mid-point is taken on these rates, the cost of eliminating this interest rate risk is roughly 3%, equating to a monthly cost of £163K or £1.95M.

4.10 However, the current composition of the portfolio is exposed to interest rate fluctuations. A 1% increase in variable interest rates (calculated on the liability benchmark) would increase interest payments by just under £1.4M per annum.

Refinancing Risk

4.11 The strategy of using inexpensive temporary borrowing to fund capital expenditure does expose the Council to a degree of refinancing risk. Whilst there is limited PWLB borrowing maturing in the next five years, over £70M of temporary borrowing from other local authorities is set to mature within the next 12 months. This source of funding is not guaranteed and rates are dictated to some extent by the supply and demand, which represents an ongoing risk.

4.12 Low interest rates mean the Council's £63M of LOBOs loans (GF share of £27M) are unlikely to be called in 2015/16. The interest rate of 4.75% is above current market rates and therefore the refinancing risk in respect of these loans is low when taking into account of prevailing market conditions. The Council will take the option to repay the LOBO loans at no cost should the opportunity arise to do so.

Strategy

4.13 The borrowing strategy for 2015/16 will continue to focus on interest costs in order to minimise the impact on the Council's overall revenue budget however it will also seek to address the GF interest rate risk exposure and refinancing risk. The approach will consider a range of options to address these aims including:

1. Continuing the process of internal borrowing;
2. Continuing temporary/ short term borrowing from other local authorities;
3. A phased programme of long-term borrowing aimed at reducing interest rate risk and refinancing risk especially for future borrowing;
4. Taking fixed rate debt to cover maturities, generating guaranteed savings;
5. Restructuring/ rescheduling existing debt.

The potential combination of these 5 approaches should help to keep interest payments at relatively low levels, whilst gradually reducing the GF's exposure to interest rate and refinancing risk.

Internal Borrowing Strategy

4.14 Following on from the previous year, it is anticipated that at 31st March 2015, the GF will be in an internally borrowed position. Essentially, this means that the level of actual debt is below the CFR, and therefore the GF has used internal resources (reserves and balances) to fund some of its unfinanced capital expenditure.

4.15 The strategy of internal borrowing has two main benefits:

- The 'cost of carry' associated with long-term fixed rate borrowing compared to investment returns is such that the use of internal resources remains an attractive means of minimising external debt payments.

- The use of internal resources reduces the funds available for investment thereby reducing credit risk. This is a key consideration given the Council's investment priority of maintaining capital.

4.16 Whilst the strategy is to reduce cash balances, the Council will aim to maintain a suitable level of liquid cash so as not to expose the Council to undue liquidity risk. This will allow decisions on further borrowing to be made using a considered approach, with flexibility around the timing of new borrowing.

Temporary Borrowing Strategy

4.17 The GF will continue to access short-term borrowing opportunities from other local authorities. The restricted lending list of most authorities means that they are willing to lend at rates of around 0.75% for periods up to one year.

4.18 The use of temporary borrowing injects volatility into the portfolio in terms of interest rate and refinancing risk, but this is offset by reduced interest costs. At a time of increasing budgetary pressures, the use of temporary borrowing is a key consideration when balancing the requirements of risk versus affordability.

4.19 Officers will attempt to mitigate the refinancing risk by spreading the maturity profile of these loans as much as possible within the constraints of what is available.

Phased Programme of Longer-Term Borrowing

4.20 Achieving a suitable balance between minimising interest costs and reducing interest rate risk and refinancing risk maintaining the long-term stability and affordability of the portfolio is a key borrowing theme. As such, consideration will also be given to undertake a phased programme of longer-term borrowing.

Maturing Loans

4.21 A list of maturing loans over the next 5 years (GF element) is shown below:

Year	2015/16	2016/17	2017/18	2018/19	2019/20
Amount	No maturity	£2.1M	£8.6M	No maturity	£34.7M
Rate	No maturity	8.6%	7.8%	No maturity	0.62%

** this represents maturity loans only. There are number of part repayments on annuity and equal installment of principal loans.*

4.22 Given the rates on the maturing loans, the Council is highly likely to make savings when it comes to replacing these loans. The aim will be to replace these loans with fixed term debt, securing interest savings whilst maintaining the risk composition of the portfolio. The exception to this is the maturity of two variable rate loans in 2019/20 totaling almost £35M which are subject to refinancing risk.

Restructuring / Rescheduling Debt

4.23 The Council will also consider restructuring / rescheduling existing fixed term loans. The low interest rate environment and changes to the regulations regarding the premature repayment of PWLB loans has limited the opportunity for any debt rescheduling. However, the Council's forecast budget deficit requires all options to be considered and this approach has the benefit of generating immediate savings.

4.24 In theory, any premature repayments will include elements of both GF and HRA debt. However, it is possible to partially repay PWLB loans, negating any potential impact on the HRA debt pool.

4.25 This strategy will need to take account of the value of exiting loans early in relation to premium costs and the level of savings that will be generated. As such this is likely to be a selective approach and will need to be part of a mixed approach to past and future borrowing

Borrowing in Advance of Need

4.26 Given the GF's internal borrowing position, it is unlikely there will be any borrowing in advance of need to fund future capital expenditure. As stated above there may be opportunities to borrow in advance of need to replace maturing loans, but this will only be undertaken where there is a clear business case for doing so.

Source of Borrowing

4.27 The Department of Communities and Local Government (CLG) confirmed in January 2015 that HM Treasury (HMT) are taking the necessary legislative steps to abolish the Public Works Loans Board (PWLB) during 2015. The CLG and HMT have stressed that this development is purely being taken to address the governance of the PWLB. **The CLG have stated that it will have no impact on existing loans held by local authorities or the Government's policy on local authority borrowing.** Despite its abolition, HMT has confirmed that its lending function will continue unaffected, albeit under a different body, so that local authorities will continue to have access to an identical range of new borrowing facilities and terms that currently exist with the PWLB.

4.28 The preferred method of borrowing will be through the HMT body that replaces the current PWLB. The only concern with regard to this source of borrowing is that the Council is heavily reliant on HMT as the primary source of long-term funding. This represents a risk and officers will continue to examine alternative options in 2015/16. The Authority has already expressed an interest in joining the Local Government Agency's (LGA) Municipal Bond Agency. The LGA bond is looking to undercut PWLB rates and will also offer an alternative for local authorities to PWLB should the government limit borrowing or artificially raise interest rates.

4.29 As stated at 4.17-4.19, the Council will continue to access funding from other local authorities. The source of funding is not guaranteed and is reliant on the cash flow position of other authorities. Officers will continue to assess the market to identify the level of refinancing risk.

4.30 Approved sources of long and short-term borrowing are:

- PWLB (and the HM Treasury body that will replace PWLB in future;
- UK local authorities;
- any institution approved for investment;
- UK public and private sector pension funds;
- capital market bond investors;
- special purpose companies created to enable joint local authority bond issues;
- commercial lenders and banks.

4.31 As stated at 4.12, the Council holds £63M of LOBOs, the GF share of £27M representing just less than 10% of GF debt. To protect against the uncertainty and refinancing risk associated with such products, no further LOBO borrowing will be undertaken.

Leasing

4.32 Leasing remains a value for money option for financing suitable assets with a defined residual value, such as vehicles. Despite the financial crisis causing some banks to withdraw from the market, the remaining funders are willing to take significant risks on the future residual value of assets, making leasing a cheaper option for financing than funding acquisitions in-house. There is also a benefit to transferring the risk associated with the residual value away from the Council.

4.33 The process for the acquisition of vehicles is under review in 2015/16. The Authority is moving away from approving a total vehicle replacement programme and towards authorising replacements on a case by case basis. The most appropriate and cost effective method of financing will continue to be identified for all assets.

5. HRA Borrowing Requirement and Strategy

5.1 Following the reform of the HRA subsidy system, on 1st April 2012 the Council notionally split each of its existing long-term loans into General Fund (GF) and Housing Revenue Account (HRA) pools.

5.2 This split included all long-term fixed and variable rate debt, from both the Public Works Loan Board (PWLB) and market sources. The HRA was apportioned debt of £269M in addition to the £22M payment made to Government to 'buy out' of the subsidy system, giving a total debt level of £291M.

5.3 Debt costs account for approximately 20% of expenditure on the business plan and therefore represent an area of key risk. Given the significance of debt management to the business plan, it is acknowledged that there is a need for a separate borrowing strategy for the HRA and this is addressed within the TMSS.

Current Debt Portfolio

5.4 Since 2012, there have been a number of part repayments of PWLB annuity and equal instalment of principal (EIP) loans lowering the debt level to £281M (November 2014). In February 2015, a PWLB maturity loan is due for full repayment. The HRA share of this loan is £2.3M, giving a forecast debt level at the end of 2014/15 of £278M.

5.5 The risk portfolio of the HRA loan pool is shown below:

Borrowing method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB – fixed (inc settlement loan £22M)	196	71	No
Market Fixed	36	13	No
PWLB – variable	46	16	Yes
TOTAL	**278**	**100**	

5.6 As at 31st March 2015, 16% of the forecast debt portfolio is sensitive to interest rate fluctuations. The PWLB variable loans (£46M) continue to represent excellent value at rates of 0.64% (£28M) and 0.61% (£18M). There is an interest rate risk associated with the loans, but the semi-annual rate fixing provides some protection against increases.

5.7 Low interest rates mean that the Council's £63M of LOBOs loans (HRA share of £36M) are unlikely to be called in 2015/16. The interest rate of 4.75% is above current PWLB levels and therefore the refinancing risk in respect of these loans is low when taking into account of prevailing market conditions.

Borrowing and Capital Financing Requirement

5.8 The Capital Financing Requirement (CFR) reflects the HRA's underlying need to finance capital expenditure by borrowing. Any capital expenditure that is not resourced immediately (from useable capital receipts, capital grants and contributions or charges to revenue) will result in an increase in the CFR.

5.9 The forecast CFR for end of the 2014/15 is £287M against a borrowing level of £278M (assuming the £2.3M is repaid). Therefore, the HRA is £9M under-borrowed. A debt level below the CFR means the HRA has been internally borrowing – using internal reserves and balances in-lieu of external borrowing.

5.10 Assuming this under-borrowed amount is subject to interest rate fluctuations, then 19% of the debt portfolio is subject to interest rate movements, as shown below:

Borrowing method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB – fixed (inc settlement loan £22M)	196	68	No
Market Fixed	36	13	No
PWLB – variable	46	16	Yes
Unfunded CFR	9	3	Yes
TOTAL	**287**	**100**	

5.11 This figure of 19% is still well within the Prudential Indicator of 25% which determines the upper threshold for variable rate exposure.

5.12 The HRA CFR has been reduced from £291M, at the implementation of Self-financing, to the forecast £287M at the end of 2014/15. The reduction is due to applied capital receipts from housing properties sold under the Right to Buy Scheme. Where sales under the Right to Buy exceed those assumed in the Self Financing Settlement the Council is allowed to retain an amount to cover the housing debt which would have been supported from the rental income on the additional properties sold. It is considered prudent to apply this funding to reduce the CFR.

5.13 The HRA 30 Year Business Plan demonstrates that HRA debt can be fully repaid by year 26 (2040/41). The accepted benchmark assessment of the viability of the plan is based on the ability to repay debt within 30 years. There is no actual requirement to repay the debt.

5.14 The asset base of the dwellings could give security for continued borrowing which would potentially allow additional investment in the stock over and above current plans. However, borrowing is limited by the debt cap set by the CLG of £301M, leaving headroom of approximately £14M.

5.15 There is no requirement to charge Minimum Revenue Provision (MRP) as with the GF CFR.

5.16 The HRA's estimated CFR is shown below:

	Estimate 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£M	£M	£M	£M
Capital Financing Requirement (CFR)	287	285	281	274
Less : Existing Profile of Borrowing	278	277	272	261
Cumulative Maximum External Borrowing Requirement	9	8	9	13
Usable Reserves	9	11	11	12
Cumulative Net Borrowing Requirement	0	(3)	(2)	1

5.17 The HRA has a limited borrowing requirement during the period to the end 2017/18 and any borrowing requirement is off-set by the HRA useable reserves.

Borrowing Strategy

5.18 The key aim of the HRA borrowing strategy is to manage the affordability of debt repayments within the 30 year business plan.

5.19 As stated, there is a limited borrowing requirement in the immediate future and any changes to the HRA working balance, for example slippage in the capital programme, will mean the HRA can fund this requirement internally. Given the limited borrowing requirement, the initial strategy will be to monitor the HRA treasury position, and to borrow short-term should any need arise.

5.20 This will avoid any 'cost of carry' associated with long-term borrowing and allow flexibility to be maintained should there be any change in the use of reserves.

Borrowing in Advance of Need

5.21 Given the HRA's limited borrowing requirement, it is unlikely there will be any borrowing in advance of need.

5.22 There may be opportunities to borrow in advance of need to fund future loan maturities, but this will only be undertaken where there is a key business case for doing so.

Premature Redemption of Debt

5.23 Given the Council's budget deficit, consideration will be given to restructuring existing fixed term loans. There is a potential impact on the HRA as the debt split was only notional so any premature repayments will include elements of both GF and HRA debt.

5.24 The Director of Corporate Services for Berneslai Homes will be consulted on any rescheduling decisions to ensure the impact on the HRA, and the 30 year business plan, are fully understood.

Charging of Debt Interest Costs

5.25 Long-term borrowing, post 1st April 2012 is allocated directly to the GF or HRA pool. Interest payable and other charges (e.g. premiums on early redemption) will be allocated to the respective revenue account.

5.26 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative.

5.27 This balance will be measured each month and interest transferred between the General Fund and HRA at the monthly average rate earned by the Council on its portfolios of treasury investments and short-term borrowing.

6. Annual Investment Strategy

6.1 The Council is required to set an Annual Investment Strategy (AIS) as prescribed in guidance from the CLG on Local Government Investments.

6.2 The Executive Director of Finance, Property & Information Services, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Treasury Management Panel.

6.3 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In 2014/15 (to 31st Dec 2014), the Council's investment balance has ranged between £27M and £93M, and similar variations are expected for the forthcoming year, depending on cash flow patterns.

6.4 Low investment risk is a key treasury objective, and to comply with the CIPFA Code and the CLG guidance, the Council's general policy objective is to invest its surplus funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's investment priorities are:

- **Security of the invested capital;**
- **Liquidity of the invested capital;**
- **Optimum yield which is commensurate with security and liquidity.**

Security (Credit and Counterparty Risk)

6.5 The 2015/16 investment strategy has been developed to take into account the continuing uncertainty within financial markets and proposed changes to the regulatory framework. Investments will not be restricted to bank deposits, and investments may be made within any public or private sector organisation or security that meet the credit rating criteria stated in Table 1. In addition, the Council may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser, Arlingclose.

6.6 The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the legislative changes brought about by the *Bank Recovery and Resolution Directive* (referred to at 2.7), **the credit risk associated with making unsecured bank deposits will increase** relative to the risk of other investment options available to the Authority.

6.7 Minimising the chance of being exposed to a failing institution remains priority, but with the probability of external support reducing it is important to focus on credit risk management and lowering loss given default through appropriate portfolio diversification.

6.8 **Approved Counterpaties:** The Authority may invest its surplus funds with any of the counterparty types in table 1 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 1: Approved Investment Counterparties and Limits

Credit Rating	* Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£10m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
BBB+	£2.5m 100 days	£5m 6 months	£2.5m 2 years	£2.5m 6 months	£2.5m 2 years
BBB or BBB-	£2.5m next day only	£5m 100 days	n/a	n/a	n/a
None	£1m 6 months	n/a	£5m 25 years	£50,000 5 years	£5m 5 years
Pooled funds	£10m per fund				

This table must be read in conjunction with the notes below:

Credit Rating: Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.
*** Separate details of unsecured investments placed with the Authority's bank account providers, Barclays, are detailed at section 6.9 below.**

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

6.9 The Barclays Flexible Interest Bearing Current Account (FIBCA) continues to be used by treasury staff to effectively manage daily cash flows and as well as giving the benefit of regular interest paid quarterly, the FIBCA also provides an additional annual interest payment. Barclays currently meets the Council's minimum credit criteria. Even if the bank's credit rating falls below the Council's minimum criteria, it will continue to use the bank for short term liquidity requirements and business continuity arrangements. An individual limit of £10M applies to the Authority's bank account provider, Barclays, (specifically the FIBCA account) in order to meet the Authority's cashflow requirements. From 1st April 2015, no new fixed term deposits will be placed with Barclays.

6.10 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

6.11 Counterparties will be individually selected for investment and as such there is no definitive list of counterparty names within this Annual Investment Strategy. The list of current eligible counterparties is updated on a weekly basis and circulated to treasury staff. Any negative credit developments that affect the counterparty list are communicated immediately. An institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

6.12 Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made;
- consideration will be given to recalling or selling any existing investments with the affected counterparty where there will be no cost to the authority.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

6.13 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

6.14 Investments made by the Authority will be classified as either Specified or Non-specified investments. The CLG Guidance defines **specified** investments as those:

- denominated in pound sterling;
- due to be repaid within 12 months of arrangement;
- not defined as capital expenditure by legislation; and
- invested with one of:-
  - the UK Government;
  - a UK local authority, parish council or community council; or

- a body or investment scheme of "high credit quality".

It should be emphasised that institutions with a rating within the single A band are considered to be 'high credit quality' (Fitch). Organisations that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher are considered 'high credit quality'. Any new specified investments will be made within the limits shown within table 1 in the AIS. For money market funds and other pooled funds 'high credit quality' is defined as those having a credit rating of A- or higher.

6.15 Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in the table below:

Table 2: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below [A-]	£30m
Total investments with institutions domiciled in foreign countries rated below [AA+]	£10m
Total non-specified investments	£60m

All non-specified investments must be approved in accordance with the authorisation procedures as detailed in Treasury Management Practice Document 5: Organisation, Clarity and segregation of Responsibilities and Dealing Arrangements. This involves prior authorisation and approval of the Head of Technical Services.

6.16 The Council's revenue reserves available to cover investment losses are forecast to be approximately £100M on 31st March 2014. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts *(e.g. King & Shaxson)*, foreign countries and industry sectors as below:

Table 3: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£15m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£15m per group
Any group of pooled funds under the same management	£15m per manager
Negotiable instruments held in a broker's nominee account (King & Shaxson)	£30m per broker
Foreign countries	£15m per country
Registered Providers	£10m in total
Unsecured investments with Building Societies	£10m in total
Money Market Funds	£30m in total
Loans to small businesses	To be determined

6.17 The Council may invest money using any of the following instruments:

- interest-bearing bank accounts;
- fixed term deposits;
- callable deposits where the Council may demand repayment at any time (with or without notice);
- certificates of deposit;
- bonds, notes, bills, commercial paper and other marketable instruments; and
- shares in money market funds and other pooled funds.

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures specified in Prudential Indicator 8 (Appendix D).

Liquidity (Liquidity Risk)

6.18 In line with the CLG investment advice on the liquidity of investments, the Council will aim to keep a proportion of the investment portfolio totally liquid (i.e. use of FIBCA and Money Market Funds).

6.19 In a period of prolonged low interest rates, accepted practice would be to lengthen the investment period to lock in to higher rates. However, the uncertainty and volatility in the financial markets has heightened credit risk. As a consequence the Council will keep the investment maturity relatively short, and this is reflected in the maturity periods specified in Prudential Indicator 10 in Appendix D.

Yield

6.20 As a result of continuing stress within the market, opportunities for investment are limited and returns are expected to remain subdued. The Council will seek to maximise returns from its investments but this will be secondary to security and liquidity priorities. Short-term money market rates are likely to remain at low levels throughout 2015/16 and this will result in reduced investment income.

6.21 Although the Council currently has a good spread of investment instruments, officers will continue to evaluate alternative investment options that meet the principles of security, liquidity and yield. Consideration will be given to alternative investment instruments and whether they are suitable for the investment portfolio, including Treasury Bills, Bonds, Housing Associations/Registered Providers and Property Funds. These types of investments provide a lower chance of default and a lower loss given default, but this may have a detrimental effect on yield. Proposals for new investment instruments will be taken to Treasury Management Panel for discussion and advice will be sought from Arlingclose prior to making any investment decisions.

Diversification

6.22 In addition to the core investment principles of security, liquidity and yield the Council will also seek to diversify investments to avoid concentration in specific banks, types of instrument, sovereign state etc.

6.23 In order to minimise the potential damaging effects of bail-in risk and the possibility of losing a proportion of capital invested, this year's investment strategy is based on wider portfolio diversification. In the event of counterparty default, wider diversification will reduce the impact on the Council's finances.

6.24 In order to diversify a portfolio largely invested in cash, investments will be placed with approved counterparties over a range of maturity periods. Maximum investment levels are set to ensure prudent diversification is achieved and these, together with minimum ratings and cash limits, are shown in Table 1.

Performance Measurement

6.25 The Council measures and manages its exposures to treasury management risks using the following indicators:

Security: The Council has adopted a voluntary measure of our exposure to credit risk by monitoring the value-weighted average credit rating of the investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target
Portfolio average credit rating	A (=6)

Liquidity: The Council has adopted a voluntary measure of our exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target
Total cash available within 3 months	£15m

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2015/16	2016/17	2017/18
Upper limit on fixed interest rate exposure	90%	90%	90%
Upper limit on variable interest rate exposure	25%	25%	25%

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

6.26 The Council also receives benchmarking information from Arlingclose which compares performance against that of their other clients. This information has the added advantages of including risk weightings and also allows comparison with other counterparties whom are receiving the same investment advice. The Council's treasury management indicators and benchmarking performance will be reported in the respective quarterly reports.

Use of Advisers

6.27 Following a tender exercise, in June 2012 the Council's current treasury management advisors, Arlingclose, were reappointed on a three year contract. The contract will therefore be up for renewal this financial year.

6.28 The CLG's guidance on Local Government Investments recommends that the AIS should comment on the use of treasury management advisers, and in particular how the Council uses external advisers and how quality of service is measured.

6.29 The services Arlingclose offer are clearly stated in the 'Schedule of Services' contained within the contract documentation. Whilst it is difficult to measure the quality of service in value added terms, Arlingclose continue to provide a professional and pro-active service and have assisted the Council in achieving their Treasury Management objectives in what has been an extremely challenging environment.

6.30 With regard to the Annual Investment Strategy, the Council's investment priorities remain security, liquidity and yield and it is the Council's relative success in meeting these objectives against which Arlingclose will be primarily assessed.

Staff Training

6.31 The CIPFA Code requires the AIS to outline the Council's approach to training of staff involved in the management of investments. The Council is committed to ensuring staff involved in Treasury Management are fully trained and possess the necessary skills to effectively discharge their role.

6.32 General training requirements are reported through the Council's Personal Development Review (PDR) process.

6.33 Staff members involved in treasury operations have previously completed the CIPFA-ACT International Treasury Management qualification. Ongoing training is accessed through Arlingclose workshops. Barnsley Financial Services is undergoing a revised staffing structure and will review the training requirements for new staff including the need to carry out the CIPFA Treasury Management qualification in future.

6.34 All training activities are recorded in accordance with Treasury Management Practice 10 – Training and Qualifications.

Berneslai Homes

6.35 The funds of Berneslai Homes continue to be ring fenced in a segregated Barclays account, with clear separation from Council funds. Officers of the Council are responsible for the management of Berneslai Homes cash balances and the account is run in accordance with Treasury Management best practice and the effective management of risk.

7. Reporting on Treasury Management and Leasing activity

7.1 As outlined at paragraph 1.5, the Executive Director of Finance, Property & Information Services will report to the Treasury Management Panel on a regular basis. It will report to Cabinet on treasury management and leasing activity / performance on a quarterly basis and produce an outturn report to Council on its treasury activity no later than 30th September after the financial year end.

7.2 The Treasury Management Panel will report to both Cabinet and Council on an exceptional basis as required. The Treasury Management Panel will also liaise with the nominated Audit Committee representatives on key issues and reports will be submitted to full Audit Committee on a minimum six monthly basis. The TM Strategy and Policy Statements and Prudential Indicators are subject to Scrutiny.

Summary

The effective identification and management of risk remains at the forefront of the Council's objectives. This is especially so given the move to housing self-financing, and the need to manage the differing requirements of the respective debt pools. The Council is determined to take a proactive approach to treasury management in what are challenging times for local government.

LIST OF APPENDICES

Appendices

A. Arlingclose Economic & Interest Rate Forecast January 2015

B. Risk Schedule

C. Policy on use of Financial Derivatives

D. Prudential Indicators

E. MRP Statement Position

Appendix A – Arlingclose Economic & Interest Rate Forecast January 2015

Underlying assumptions:

- The UK economic recovery slowed towards the end of 2014, with economic and political uncertainty weighing on business investment. However, the Q3 growth rate of 0.7% remains slightly above the long run average, suggesting the recovery remains robust.
- Household consumption is key to the recovery in 2015. While we expect consumption growth to slow, given softening housing market activity and slower employment growth, the fall in inflation and resulting rise in both real (and nominal) wage growth and disposable income should support spending.
- Inflationary pressure is currently low (annual CPI is currently 0.5%) and is likely to remain so in the short-term. The fall in oil prices has yet to feed fully into the prices of motor fuel and retail energy and CPI is expected to fall further. Supermarket price wars are also expected to bear down on food price inflation.
- The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.
- Nominal earnings growth is strengthening, but remains relatively weak in historical terms, despite large falls in unemployment. Our view is that spare capacity remains extensive. The levels of part-time, self-employment and underemployment are significant and indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.
- However, we also expect employment growth to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure.
- In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone. These factors will maintain the dovish stance of the MPC in the medium term. The MPC clearly believes the appropriate level for Bank Rate for the post-crisis UK economy is significantly lower than the previous norm. We would suggest this is between 2.5 and 3.5%.
- The ECB has introduced outright QE as expected. While this may alleviate some of the anxiety about the economic potential of the Eurozone, political risk remains significant (e.g. Greek election). Therefore fears for the Eurozone are likely to maintain a safe haven bid for UK government debt.

Forecast:

- We continue to forecast the first rise in official interest rates in Q3 2015, but the risks to this forecast are very much weighted to the downside. The February Inflation Report will be key to our review of the possible path for Bank Rate.

- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited; we believe the normalised level of Bank Rate post-crisis to range between 2.5% and 3.5%.

- Market sentiment (derived from forward curves) has shifted significantly lower in the past three months; market expectations are now for a later increase in interest rates and a more muted increase in gilt yields.

- The short run path for gilt yields has flattened due to the sharp decline in inflation expectations. We project gilt yields on an upward path in the medium term.

- The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. We project gilt yields on an upward path in the medium term.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75
Downside risk			0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.55	0.60	0.80	0.90	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.95	2.00
Downside risk	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	0.95	0.95	0.95	0.95	1.00
1-yr LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.95	1.00	1.20	1.30	1.45	1.55	1.70	1.80	1.95	2.05	2.20	2.35	2.40
Downside risk	0.15	0.20	0.30	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.80	0.80	0.80
5-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50
Arlingclose Central Case	1.10	1.20	1.30	1.40	1.50	1.65	1.80	1.95	2.10	2.20	2.35	2.40	2.50
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.70	0.75
10-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.55	0.55
Arlingclose Central Case	1.60	1.70	1.80	1.90	2.00	2.15	2.30	2.45	2.60	2.70	2.85	2.90	3.00
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.75	0.80
20-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	2.10	2.20	2.30	2.35	2.45	2.50	2.65	2.75	2.90	3.00	3.15	3.20	3.30
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90
50-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	2.15	2.25	2.35	2.40	2.50	2.55	2.70	2.80	2.95	3.05	3.20	3.25	3.35
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90

Council's approach to risk management

The following schedule contains information from the Treasury Management Practice documents and the Council's risk management software, and provides a summary as to how the Council manages the various treasury management risks.

1. **Risk** : Credit and counterparty risk is the risk of failure by a third party to meet its contractual obligations to the Council under an investment.
   Mitigation : Credit & Counterparty risk is addressed through the use of the Annual Investment Strategy (AIS) as detailed in Section 6. The implications of 'Bail-in' will impact on the ratio of probability of loss. The AIS aims to reduce the impact through diversification whilst acknowledging that the probability of default will potentially increase.
   Probability : Medium
   Impact : High

2. **Risk** : Liquidity risk is the risk that cash will not be available when it is needed.
   Mitigation : The Council has access to short-term funding through the money markets and borrowing is also readily available from the PWLB.
   The Council will also aim to keep a proportion of investments totally liquid i.e. with immediate access as referred to in the AIS (at 6.25).
   Probability : Low
   Impact : Medium

3. **Risk :** Interest Rate risk is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances.
   Mitigation : Both the HRA and particularly the GF debt pools are subject to a degree of interest rate risk. The balancing of risk against cost is a key theme for 2015/16 and is addressed in detail throughout the TMSS.
   Probability : Medium
   Impact : Very High

4. **Risk :** Exchange rate risk is the risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the Council's finances.
   Mitigation : None – the Council undertakes minimal foreign currency transactions, so the risk is negligible.
   Probability : Very Low
   Impact : Very Low

5. **Risk :** Refinancing risk is the risk that maturing borrowings cannot be refinanced on terms that reflect the provisions made by the Council.
   Mitigation : . The GF has a significant amount of temporary borrowing which will need to be refinanced and this is addressed in the borrowing strategy. The PIs place limits on the maturity structure of borrowing to limit the refinancing risk.
   Probability : Medium
   Impact : High

6. **Risk :** Legal and regulatory risk is where the Council fails to act in accordance with its legal powers or regulatory requirements, and suffers losses accordingly.

Mitigation : The Council receives professional advice from Treasury Management advisors and officers receive regular training updates.
Probability : Low
Impact : Low

7. **Risk :** Fraud error and corruption and contingency management risk is the risk that the Council fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings.
   Mitigation : Internal Audit carry out an annual regulatory review of the treasury management function including probity testing. The recommendations of these reports are actioned in accordance with the agreed timetable.
   Probability : Low
   Impact : Medium

8. **Risk :** Market risk is the risk that through adverse market fluctuations in the value of the principal sums the Council invests, its stated investment objectives of security of capital is compromised.
   Mitigation : The use of alternative investments vehicles such as property funds may increase the level of market risk. Investment in such instruments will only be undertaken after rigorous assessment and on the advice of Arlingclose.
   Probability : Medium
   Impact : Medium

APPENDIX C

Policy on use of Financial Derivatives

1. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of financial derivatives. The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the TMSS.

2. The Council will only use derivatives where they can be clearly demonstrated to reduce the overall level of financial risk

3. Derivatives may be arranged with any organisation that meets the Council's approved investment criteria.

4. The Council will only use derivatives after seeking a legal opinion and ensuring that officers have the appropriate training to effectively manage their use.

APPENDIX D

1. Capital Expenditure

	Current Estimate 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£M	£M	£M	£M
General Fund (GF)	46	45	22	33
Housing Revenue Account (HRA)	42	48	24	21
TOTAL	**88**	**93**	**46**	**54**

2. Ratio of Financing Costs to Net Revenue Stream

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	%	%	%	%
GF	14	14	15	15
HRA	44	43	43	43

3. Capital Financing Requirement

	Current Estimate 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£M	£M	£M	£M
GF	633	642	630	616
HRA	287	285	281	274
TOTAL	**920**	**927**	**911**	**890**

4. Estimates of the Incremental Impact of Capital Decisions on Council Tax / Rents

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£	£	£	£
Increase in Band D Council Tax	8.51	8.30	8.30	8.30
Increase in Average Weekly Housing Rents	1.06	1.19	3.04	4.32

5. Authorised Limit for External Debt

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£M	£M	£M	£M
Borrowing	727	734	730	738
Other Long-term Liabilities	238	231	235	227
TOTAL LIMIT	**965**	**965**	**965**	**965**

6. Operational Boundary for External Debt

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£M	£M	£M	£M
Borrowing	712	719	715	723
Other Long-term Liabilities	238	231	235	227
TOTAL LIMIT	**950**	**950**	**950**	**950**

7. Adoption of CIPFA code of Practice in TM

The Council adopted the CIPFA Code of Practice on Treasury Management on 13th February 2002.

8a. Interest Rate Exposure - GF

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	%	%	%	%
Upper Limit for Fixed Interest Rate Exposure	90	90	90	90
Upper Limit for Variable Rate Exposure	25	25	25	25

8b. Interest Rate Exposure – HRA

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	%	%	%	%
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100
Upper Limit for Variable Rate Exposure	25	25	25	25

9a. Maturity Structure of Borrowing - GF

	Approved 2014/15		2015/16	
	Lower Limit	Upper Limit	Lower Limit	Upper Limit
Less than 12 months	0%	50%	0%	50%
12 months & within 24 months	0%	25%	0%	25%
24 months & within 5 years	0%	25%	0%	25%
5 years & within 10 years	0%	25%	0%	25%
10 years & within 20 years	0%	75%	0%	75%
20 years and within 30 years	0%	75%	0%	75%
30 years and within 40 years	0%	75%	0%	75%
40 years and within 50 years	0%	75%	0%	75%
50 years and above	0%	75%	0%	75%

9b. Maturity Structure of Borrowing - HRA

	Approved 2014/15		2015/16	
	Lower Limit	Upper Limit	Lower Limit	Upper Limit
Less than 12 months	0%	25%	0%	25%
12 months & within 24 months	0%	25%	0%	25%
24 months & within 5 years	0%	25%	0%	25%
5 years & within 10 years	0%	25%	0%	25%
10 years & within 20 years	0%	75%	0%	75%
20 years and within 30 years	0%	75%	0%	75%
30 years and within 40 years	0%	75%	0%	75%
40 years and within 50 years	0%	75%	0%	75%
50 years and above	0%	75%	0%	75%

10. Maximum Principal Sums Invested

	Approved 2014/15	Year 1 2015/16 Estimate	Year 2 2016/17 Estimate	Year 3 2017/18 Estimate
	£M	£M	£M	£M
Principal Sums Invested > 364	20	20	20	20
Principal Sums Invested > 2yrs	20	20	20	20
Principal Sums Invested > 3yrs	20	20	20	20

11. Gross Debt and CFR

Gross Debt & CFR	2015/16 Estimate
	£M
Outstanding Borrowing	561
Other Long-term Liabilities	231
Gross Debt	**792**
Max CFR	927
Headroom	**135**

APPENDIX E

2015/16 MRP STATEMENT

The Council is required to make a prudent provision for debt redemption known as the Minimum Revenue Provision (MRP). Guidance on MRP has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

NB This does not preclude other prudent methods.

MRP in 2015/16: Options 1 and 2 may be used only for General Fund supported expenditure. Methods of making prudent provision for General Fund self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses). **There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.**

The MRP Statement is required to be submitted to Council before the start of the 2015/16 financial year for approval. The Council is recommended to approve the following statement:

- **For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined in accordance with the former regulations that applied on 31st March 2008 – Option 1. Option 3 will be applied in respect of unsupported capital expenditure. (The Authority will undertake a review in 2015/16 of MRP and how Option 1 has been applied).**

- **Within Option 3 revenue provision is calculated in one of two ways – equal instalments or annuity method. Each capital project will be individually assessed to determine the most appropriate method of calculation.**

- **MRP will normally commence in the financial year following the one in which expenditure is incurred, however MRP Guidance permits authorities to defer MRP until the financial year following the one in which the asset becomes *operational*. The Council has chosen to employ this "MRP holiday" on the significant qualifying projects such as the Building Schools for the Future programme.**

MRP in respect of Private Finance Initiative (PFI) and leases brought on balance sheet under the International Financial Reporting Standard Code of Practice will match the annual principal repayment for the associated deferred liability. This approach will produce an MRP charge comparable to that under option 3 in that it will run over the life of the lease/PFI scheme.