For:	(x)
Executive	☒
CLMT	☐

Meeting Date: 9th February 2015
Report of: Head of Corporate Finance
Report author: Barry Crick

Agenda Item Number: 11

Subject: Treasury Management and Annual Investment Strategy 2015/16 (For Executive Only) **Lead Executive Member(s):** Councillor Ashraf **Wards Affected:** None	<u>Consultations:</u> (x) Councillors ☐ Scrutiny ☐ Stakeholders ☐ Others ☐

Recommendations

Executive is asked to approve, for submission to full Council:

a) **the Treasury Management Strategy and Statement**
b) **the Annual Investment Strategy 2015/16 which includes the Minimum Revenue Provision Statement**
c) **The Council's prudential indicators shown in tables at paragraphs 14,17, 43, 44, 45, 49, 50, 51, 58 and 84**

Background

1. 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 needed. Surplus cash is invested in low risk counterparties providing adequate liquidity initially before considering investment return

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

3. The Chartered Institute of Public Finance & Accountancy (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"

<u>Reporting requirements</u>

4. The Council is required to receive and approve three main reports each year, which incorporate a variety of policies, estimates and actuals. There is scrutiny of these reports by the Audit and Governance Committee.

Treasury Management and Annual Investment Strategy including Minimum Revenue Provision (this report**)**

6. This report covers

   - the Council's capital plans (including prudential indicators);
   - minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time)
   - how the investments and borrowings are to be organised and the parameters put in place

Mid Year Treasury Management Report

7. This report updates members with the progress of the capital position, amending prudential indicators where necessary and whether the treasury strategy is being adhered to or whether policies require revision. In addition the Executive receives quarterly activity reports.

Annual Treasury Management Report

8. This provides details of actual prudential and treasury indicators and the actual treasury operations compared to the estimates within the strategy.

Scrutiny

9. The above reports are submitted to Audit & Governance for scrutiny.

Treasury Management Strategy for 2015/16

10 The strategy covers two main areas:

Capital Issues

- the capital plans and prudential indicators
- the Minimum Revenue Provision strategy

Treasury Management Issues

- the current treasury position
- treasury indicators
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the annual investment strategy
- creditworthiness strategy
- policy on use of external service providers

Training

11 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management and the training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

12 The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

It is recognised that responsibility for treasury management decisions remains with the Council at all times and that undue reliance will not be placed upon our external service provider

It is also recognised 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.

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Current Position

CAPTAL PRUDENTIAL INDICATORS 2015/16 to 2017/18

13 The council's capital expenditure plans are the key driver of treasury management activity. The effect of these plans are reflected in the prudential indicators which are designed to assist members overview and confirm the capital plans.

Capital Expenditure

14 This prudential indicator is a summary of the Council's capital expenditure plans, both those approved previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts

Capital Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
General Fund	63,021	92,948	53,431	27,937	24,027
HRA	14,897	23,262	28,945	17,905	12,094
Capital Expenditure	**77,918**	**116,210**	**82,376**	**45,842**	**36,121**

15 The table below summarises the above capital expenditure plans and how they are to be financed either by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

	2013/14	2014/15	2015/16	2016/17	2017/18
Capital Expenditure	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
General Fund	63,021	92,948	53,431	27,937	24,027
HRA	14,897	23,262	28,945	17,905	12,094
Total	77,918	116,210	82,376	45,842	36,121
Financed by					
Capital Receipts	1,225	8,722	10,238	9,776	3,968
Capital Grant	46,353	57,634	34,010	25,402	23,974
Capital/Revenue reserves	17,406	28,253	8,179	6,403	6,891
Total	64,984	94,609	52,427	41,581	34,833
Net financing need (	12,934	21,601	29,949	4,261	1,268

inc PFI)					

The Council's Borrowing Need (Capital Financing Requirement)

16 The Capital Financing Requirement (CFR) prudential indicator is 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 minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

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17 The Council is asked to approve the CFR projections below

Capital Financing Requirement	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
	£'000	£'000	£'000	£'000	£'000
General Fund	186,395	202,253	206,408	203,198	197,948
Housing	109,397	111,257	123,257	129,257	129,257
Total CFR Indicator	**295,762**	**313,510**	**329,665**	**332,455**	**327,205**

Movement in CFR represented by					
Net financing need in year	12,934	21,601	29,949	4,261	1,268
Less MRP and other financing movements	10,706	3,853	13,794	1,471	-6,518
Movement in CFR	2,228	17,748	16,155	2,790	-5,250

Minimum Revenue Provision Policy Statement

18 In March 2008 the Secretary for State for Communities issued statutory guidance recommending that each local authority should prepare a statement of policy setting out how it will make a prudent Minimum Revenue Provision (MRP) for the next financial year, and submit that statement of policy to Full Council

19 Government wishes to ensure that elected members have the opportunity to scrutinise the ways in which officers propose to ensure that a prudent provision is made.

Explanation of Minimum Revenue Provision

20 Authorities borrow to fund capital spend. A capital item should last many years, and benefit taxpayers over that period of years. Borrowing enables the costs of long-lasting items to be spread over the useful life of the item. This is standard accounting practice in all sectors

21 There are two types of costs of borrowing: first, the costs of interest payments, and second, the costs of actually repaying the debt, or principal

22 The Minimum Revenue Provision on the general fund is the amount shown in the accounts for debt repayment, that hits the bottom line, and so is part of the Council Tax calculations

23 In the private sector, the focus is on depreciation – measuring how much of the value of an asset has been used in a year. This has not historically been the case in Councils, due to past regulation, and if full depreciation was included in the Council Tax calculations, it would add very significantly to costs. It should also be noted that no minimum revenue provision is required for the Housing Revenue Account. If one was made it would impact on the housing rent calculation

24 The basic Minimum Revenue Provision calculation was originally based on a charge of 4% of the amount outstanding each year, so assumes that the cost of a capital asset can reasonably be spread over many years. If the useful life of an asset is likely to be much shorter, as in the case of a vehicle, or IT equipment, a different method is needed to ensure that future generations are not left with the cost of paying for former assets that give them no value. Before the introduction of the statutory guidance, Luton addressed this by making an additional voluntary revenue provision, to ensure charges matched the expected useful life of the assets concerned. The statutory guidance introduced an option called the 'asset life method', with similar effect, to determine the MRP for such assets.

Policy

25 In accordance with suggestions in the statutory guidance, a variety of approaches will be used for the differing types of capital expenditure.

26 For some capital spend, known as supported capital expenditure, the Government includes an element within the Council's formula grant to help pay off the debt each year. For any new supported borrowing, the Council will use the Regulatory Method, as set out in option 1 of the statutory guidance.

27 For capital expenditure prior to 31 March 2007, the Council uses the Regulatory Method, except where a voluntary revenue provision was made previously, due to the asset's expected life being of a short duration. In such cases, the voluntary revenue provision will be continued until adequate provision has been made.

28 For the avoidance of doubt, it is noted that the regulatory method is also used for all capital spend and debt transferred to Luton in relation to past spend by Bedfordshire County Council on Luton-related assets

29 Prior to the guidance being issued, Councils were legally required to use the regulatory method, so using this simply means making provision in the same way that the Government required local authorities to do for many years. Within this method, the Council will take advantage of the ability to make the commutation adjustment for the current year, as this is in the Council's favour (that is, by reducing the amount that would otherwise have to be charged in the year to the taxpayer). The commutation adjustment relates to old house renovation debt, and was introduced by Government when the method for accounting for that debt was changed many years ago. As stated in the guidance, the calculations of the amount chargeable under this method will also take into account the 'Adjustment A' factor set in 2004/05 (this adjustment was created by Government in 2004 to ensure that the move from the previous system to the Prudential Code introduced at that time did not result in any increased liability that could impact on council tax payers).

30 For existing and new borrowing after 31 March 2007 which is not supported by Government, the Council changed its approach in 2011/12 and now uses the annuity method, under which equal debt repayments are made each year of the sum total of principal and interest, based on the Council's average loan interest rate for the year in which the payments start. The amounts of principal repayments are calculated so that by the end of the asset's life the principal is fully repaid.

31 So the amount of principal repayment (the MRP) varies dependent on the amount of interest payable in the year. Interest will be greater at the beginning of the loan, when all the principal is outstanding, so the amount of principal repayment is lower in the initial years. It can be argued that this method takes account of the time value of money, and, taking principal and interest together, produces a consistent annual change over an asset's life. It was originally seen as being appropriate for assets that generate income

32 The external auditor was consulted on this approach last year and was comfortable with it.

33 Freehold land without a structure on it will be written off over 50 years, in accordance with the guidance. Land with a structure on it will be written off over the same period as the expected life of the structure.

34 In the case of major new assets with an extended construction period, the Council will only begin requiring an MRP to be made in the year following the asset being brought into use. This is in accordance with paragraph 13 of the statutory guidance, which describes this option as an 'MRP holiday'.

35 For any finance leases, and any on-balance sheet public finance initiative (PFI) schemes, the charge required in accordance with proper practices will also cover the MRP.

36 Should the Council apply for, receive, and use any capitalisation directions in the year, it will use the 'Equal Instalment' version of the 'Asset Life Method', option 3a in the statutory guidance. This means that an estimate will be made of the life of the asset, and the Council will then write off the debt in equal instalments over each year of the expected life. That life will be determined in accordance with the maximum value shown in the table set out in paragraph 24 of the statutory guidance.

37 During 2011 a Local Authority Mortgage Scheme was launched to assist first time buyers onto the property ladder. The Council has participated in the scheme and deposited £1m to Lloyds TSB for a 5 year period matching the indemnity life. This deposit provides an integral part of mortgage lending and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) includes the deposit with Lloyds. The deposit is due to be returned in full at maturity with interest paid annually .Once the deposit matures the returned funds will be classed as a capital receipt and the CFR reduced accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. Should a similar scheme be introduced which does not involve any deposit with a bank or building society, there would not be an impact on the CFR or MRP.

38 No revenue charge was previously required for the Housing Revenue Account (HRA). However under HRA self financing the HRA is required to charge depreciation on its assets, which has a revenue effect. In order to address the potential adverse impact, regulations now allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years, so there is no change in the short term.

39 The Council can make an additional voluntary provision to repay debt where it appears financially appropriate to do so, and is in accordance with regulation. No additional provision is included in the 2012/13 budget.

40 Where the Council makes secured capital loans, for example to London Luton Airport Limited, and potentially to other public sector bodies and registered social landlords, no MRP will be charged. This is because the stated aim of the MRP is to make prudent provision, which is broadly to ensure that debt is repaid over a period broadly commensurate with the period over which the capital expenditure provides benefits. If the loan is properly secured and repayable over or at the end of the period in which it provides benefits, then the

loan repayment ensures that the debt is repaid, and MRP would double-up the provision. It is however essential that proper accounting practice is followed, and an appropriate provision is made should any doubt emerge about whether a loan will be repaid.

The use of the Council's Resources and Investment Position

41 The application of existing 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).

Affordability Prudential Indicators

42 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.

Ratio of financing costs to net revenue stream

43 This indicator identifies the trend in the cost of capital(borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this report.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%
General fund	**11.37**	**9.83**	**9.92**	**11.05**	**12.43**
HRA	**43.55**	**45.59**	**47.21**	**46.35**	**45.89**

Incremental impact of capital investment decisions on council tax – Band D

44 This indicator identifies the revenue costs associated with proposed changes to the capital programme recommended in this report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will include some estimates, such as the level of Government support.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£
Council Tax Band D	**-8.80**	**-1.65**	**22.78**	**32.77**	**32.69**

Incremental impact of capital investment decisions on housing rent levels

45 This indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this report compared to the Council's existing commitments and current plans expressed as an impact on weekly rent levels.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£
Weekly rent levels	**7.50**	**7.50**	**7.50**	**7.50**	**7.50**

BORROWING

46 The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet all cash commitments. This will include borrowing for capital purposes when necessary. The strategy covers the relevant treasury /prudential indicators , the current and projected debt positions and the annual investment strategy. The General Fund will continue to manage the Council's debt portfolio, and will recharge the Housing Revenue Account (HRA) under a proper accounting approach.

Current Portfolio Position

47 The Council's treasury portfolio position at 31 March 2014, with forward projections are summarised in the following table. The table shows the actual external debt against the underlying borrowing need (CFR) highlighting any over or under borrowing.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Debt o/s 1 April	293,211	293,211	295,411	270,411	274,212
Change in debt	0	2,200	-25,000	0	20,000
Other Long Term Liabilities (OLTL)	23,690	23,317	22,981	22,609	22,243
Debt and OLTL O/s 31 March	316,901	318,728	293,392	293,020	316,455
CFR	295,762	313,510	329,665	332,455	327,205
PFI (Challney girls)	23,690	23,317	22,981	22,609	22,243
Over(+)/Under(-) borrowing	-2551	-18,099	-59,254	-62,044	-32,993

48 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within 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 CFR in the preceding year plus estimates of an additional CFR for 2015/16 and the following two financial years. As can be seen from the table above the Council is on course to comply with this prudential indicator in the current year.

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

Operational Boundary

49 This is the limit beyond which external debt is not normally expected to exceed

	2014/15	2015/16	2016/17	2017/18
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
Borrowing	336,510	336,846	337,218	337,584
Other Long Term Liabilities	23,317	22,981	22,609	22,243
Total	**359,827**	**359,827**	**359,827**	**359,827**

Authorised Limit

50 This indicator represents a control on the maximum level of debt .This being the limit beyond which external debt is prohibited.

	2014/15	2015/16	2016/17	2017/18
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
Borrowing	346,510	346,228	347,218	347,584
Other Long Term Liabilities	23,317	22,981	22,609	22,243
Total	**369,827**	**369,827**	**369,827**	**369,827**

51 The Council is also limited to a maximum HRA CFR through the HRA self financing regime.

HRA Debt Limit	2014/15	2015/16	2016/17	2017/18
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
HRA Debt Cap	129,261	129,551	133,646	133,646
HRA CFR	**111,257**	**123,257**	**129,257**	**129,257**
HRA Headroom	18,004	6,294	4,389	4,389

PROSPECT FOR INTEREST RATES

52 The Council retains capita Asset Services as treasury advisor to the Council and part of their service, in addition to other City forecasts, is to assist the Council to formulate a view on interest rates. The table below shows their central view.

PWLB Rates

Annual Average	**Bank Rate**	**5 yr**	**10 yr**	**25 yr**	**50 yr**
	%	%	%	%	%
Jan 15	0.50	2.00	2.60	3.30	3.30
Mar 15	0.50	2.20	2.80	3.40	3.40
Jun 15	0.50	2.20	2.80	3.50	3.50
Sep 15	0.50	2.30	3.00	3.70.	3.70
Dec 15	0.75	2.50	3.20	3.80	3.80
Mar 16	0.75	2.60	3.30	4.00	4.00
Jun 16	1.00	2.80	3.50	4.20	4.20
Sep 16	1.00	2.90	3.60	4.30	4.30
Dec 16	1.25	3.00	3.70	4.40	4.40
Mar 17	1.25	3.20	3.80	4.50	4.50
Jun 17	1.50	3.30	3.90	4.60	4.60
Sep 17	1.75	3.40	4.00	4.70	4.70
Dec 17	1.75	3.50	4.10	4.70	4.70
Mar 18	2.00	3.60	4.20	4.80	4.80

53 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest

recovery in recent history. However, growth rebounded in 2013 and continued into 2014 surpassing initial expectations, having been propelled by the recovery in consumer spending and the housing market. Growth prospects for 2015 are relatively positive, particularly in the services and construction sectors, though growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone. Economists are of the opinion that a significant rebalancing of the economy is required ,moving away from consumer spending to manufacturing, business investment and exporting in order for the recovery to become more firmly established. One drag on the economy is that wage inflation has been running lower than CPI inflation (at least until December) which has the knock on effect of eroding disposable income and living standards although tax cuts have softened the blow to some extent. To correct this situation labour productivity has to improve significantly to warrant increases in pay rates.

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

- Concerns in respect of a major crisis over in the Eurozone subsided considerably in 2013. However the downturn in growth and inflation during the second half of 2014 and worries over the Ukraine situation, Middle East and Ebola have led to a resurgence of those concerns. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not properly address low growth, international competitiveness and the need for reforms of their economies. It is possible that over the next few years levels of government debt to GDP ratios could continue to rise to levels that could lead to loss of investor confidence in the financial viability of such countries and an elevated counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods.

- Investment returns will remain low during 2015/16 and in subsequent years

- Borrowing rates have been volatile during 2014 as alternating bouts of good and bad news promoted optimism, and then pessimism, in financial markets. Negative news through from July to October led to a trend of falling rates. The policy of using spare cash balances in recent years will need to be carefully reviewed to avoid future higher borrowing costs when cash balances may be more scarce and new capital expenditure needs financing.

- There will remain a cost of carry to any borrowing undertaken which causes a temporary increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

BORROWING STRATEGY

55 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.

56 Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. the Head of Finance will monitor interest rates in the financial markets and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Executive as part of the regular treasury management reporting:

- if it was felt that there was a significant risk of a sharp fall in long and short term interest rates, due to a marked increase of risks around relapse into recession or risk of deflation, then long term borrowing will be postponed, and potential rescheduling of 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 interest rates than that currently forecast, perhaps arising from increased 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 year.

Local government Association (LGA) - Municipal Bonds Agency

57 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 hoped that borrowing rates will be lower than those offered by the Public Works Loan Board. The Council may make use of this new source of borrowing as and when appropriate.

Treasury Management Limits on Activity

58 There are a number of debt/investment related treasury activity limits. The purpose of these is 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.

- 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.

The Council is asked to approve the following treasury indicators and limits:

Interest rate exposure

	2014/15	2015/16	2016/17
	Upper	Upper	Upper
	£'000	£'000	£'000
Fixed Rate - Net Debt	**25,000**	**25,000**	**25,000**
Variable Rate - Net Debt	**7,500**	**7,500**	**7,500**
Fixed Rate - Total Debt	**30,000**	**30,000**	**30,000**
Variable Rate – Total Debt	**9,000**	**9,000**	**9,000**
Fixed Rate - Investments	**5,000**	**5,000**	**5,000**
Variable Rate - Investments	**5,000**	**5,000**	**5,000**

Maturity Structure of fixed interest rate borrowing 2015/16

	Lower	Upper	2015/16	2015/16
			£'000	**%**
Under 12 months	**0%**	**0%**	**25,000**	**9.55**
12 months to 2 years	**0%**	**100%**	**0**	**0.00**
2 years to 5 years	**0%**	**100%**	**0**	**0.00**
5 years to 10 years	**0%**	**100%**	**117,838**	**45.01**
10 years to 20 years	**0%**	**100%**	**5,997**	**2.29**
20 years to 30 years	**0%**	**100%**	**7,500**	**2.86**
30 years to 40 years	**0%**	**100%**	**37,500**	**14.32**
40 years to 50 years	**0%**	**100%**	**42,976**	**16.42**
50 years and above	**0%**	**100%**	**25,000**	**9.55**
			261,811	**100.00**

Maturity Structure of variable interest rate borrowing 2015/16

	Lower	Upper	2015/16	2015/16
			£'000	**%**
Under 12 months ****	**0%**	**100%**	**33,600**	**100.00**
12 months to 2 years	**0%**	**100%**	**0**	**0.00**
2 years to 5 years	**0%**	**100%**	**0**	**0.00**
5 years to 10 years	**0%**	**100%**	**0**	**0.00**
10 years and above	**0%**	**100%**	**0**	**0.00**
20 years to 30 years	**0%**	**100%**	**0**	**0.00**
30 years to 40 years	**0%**	**100%**	**0**	**0.00**
40 years to 50 years	**0%**	**100%**	**0**	**0.00**
50 years and above	**0%**	**100%**	**0**	**0.00**
			33,600	**100.00**

******* This figure represents Money Market Loans with call periods of less than I year

POLICY ON BORROWING IN ADVANCE OF NEED

59 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 security of such funds.

60 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.

DEBT RESCHEDULING

61 Short term borrowing rates are considerably lower than longer term fixed interest rates and there is an argument for switching some existing debt from long term to short term debt to create savings. However premature repayment of debt would incur large premiums which currently would far and away exceed any savings created by lower interest rates.

62 The reasons for rescheduling to take place include:

- to generate cash savings
- to help fulfil the treasury strategy
- enhance the balance of the debt profile

63 If circumstances allow then consideration will be given to using maturing investment balances to prematurely repay debt as returns on investments are lower than rates paid on debt

64 All rescheduling will be reported to the Executive at the earliest meeting following its action

ANNUAL INVESTMENT STRATEGY

Changes to credit rating methodology

65 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. More recently, in response to the evolving regulatory regime, the agencies have indicated that they may remove these 'uplifts'. This process is likely to commence late in early 2015/16 although the actual timing of the changes is still under discussion. This means that immediate changes to the credit methodology are necessary.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings throughout the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide 'standalone' credit ratings for financial institutions. For Fitch, it is the Viability rating, while Moody's has the Financial Strength rating. Due to the future removal of sovereign support from institution assessments , both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point in monitoring both Long Term and these 'standalone' ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to reflect ' a bank for which there is a possibility of external support but it cannot be relied upon'. With all institutions likely to drop to these levels , there is little to no differentiation to be had by assessing support ratings.

As a result of these rating agency changes , the credit element of Capita's future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that Capita have always have always taken, but a change to the use of Fitch and Moody's ratings. CDS prices will continue to be utilised as an overlay to the ratings.

Investment Policy

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

67 In accordance with the above, 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..

68 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fall. The withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions, resulting in the key ratings used to monitor counterparties being the Short and Long Term ratings. Viability, financial Strength and support ratings will effectively become redundant. This change does not reflect deterioration in the credit environment rather a change of method in response to regulatory changes.

69 It is recognised that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the economy and political environment and have regard to market comment. Capita Asset services monitor market pricing and provide information, as an overlay to the ratings, through Credit Default Swap analysis.

70 Other information sources used include the financial press, share price movement and other such information relating to the banking sector.

71 The aim of the strategy is to generate a list of high creditworthy counterparties which will enable diversification and avoid concentration risk.

72 Investment instruments identified for use are shown at Appendix A under the ‘specified and non-specified categories’.

Creditworthiness Policy

73 The Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moodys and Standard and Poors. The credit ratings of institutions 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 institutions from only the most creditworthy countries.

74 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 to determine the duration of the Council’s investments. the Council will therefore use institutions within the following durational bands::

- Yellow - 5 years (AAA rated Government debt or equivalent)
- Purple - 2 years
- Blue - 1 year (only applies to nationalised or part nationalised banks)
- Orange - 1 year
- Red - 6 months
- Green - 100 days
- No colour - Not to be used

	Colour (and long term rating where applicable	Maximum Cash Exposure Limit (or 30% of total Investments)	Maximum Duration Limit
UK Government Bonds or equivalent	Yellow	5%	5 years
Banks/Building Societies	Purple	£25m	2 years
Banks/Building Societies	Orange	£22.5m	364 days
Banks/Building Societies	Red	£15m	6 months
Banks/Building Societies	Green	£11.5m	100 days
Banks/Building Societies	No colour	Not to be used	
Local Authorities	N/A	£15m	5 years
Money Market Funds	AAA	£22.5m	Liquid
Part Nationalised Banks	Blue	£30m	2 Years

75 The Capita creditworthiness service uses a wider array of information than just primary ratings and by using the risk weighted scoring system the credit opinion of all the agencies is take into account for each facet of information required to build up a rating.

76 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 institutions' 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 that supports their use.

77 All credit ratings will be monitored weekly and the Council 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 institution/investment scheme /country no longer meeting the Council's minimum criteria , its further use as a new investment will be withdrawn immediately

- should an institution/investment scheme/country counterparty be upgraded then they will be moved into the appropriate band on the Council's lending list thereby increasing their cash exposure and maturity limits, the opposite action will be taken should a downgrade occur

- if a counterparty is placed on monitoring, on the CDS Swap overlay then they will be moved down a band on the Council's list thereby reducing both their cash exposure and maturity limit

78 As mentioned previously sole reliance will not be placed on the use of this external service. In addition the Council will use market data and information, information on government support for banks and the credit ratings of that supporting government.

Country Limits

79 The Council has determined that it will only use approved counterparties from countries with a minimum credit rating of AA+. The list of countries that qualify using this criteria as at the date of this report is shown at Appendix B . This list will be added to, or deducted from in accordance with this policy.

Local Authority Mortgage Scheme (LAMS)

80 As mentioned previously the Council is currently participating in the cash backed mortgage scheme which required the Council to place a matching five year deposit to the life of the indemnity. The investment is an integral part of the policy initiative and is outside the criteria above.

Investment Strategy

In-house funds

81 Investments will be made with reference to the core balance, cash flow requirements and the outlook for short term interest rates (up to 12 months).

82 **Investment return expectations**

Bank rate, currently 0.50%, is forecast to begin to rise during 2015 and continue to gradually rise over the next few years, With this in mind the Council will adopt a cautious approach and build in the following rates for investment earnings each year:-

- 2015/16 - 0.55%
- 2016/17 - 0.95%
- 2017/18 - 1.20%
- 2018/19 - 1.50%
- 2019/20 - 1.50%

83 It is likely that the Council's current practice of using maturing investments to assist the funding of cash flow will continue, particularly in light of the predicted returns shown above. In recent years the Council's investment return has been boosted by beneficial rates offered by the part Government owned banks, Lloyds and Royal Bank of Scotland. At present, despite the greenlight offered by the Council's treasury management advisors Capita, the Council have suspended making any further investments with the Royal Bank of Scotland having regard to concern expressed advisors Arlingclose, who provide advice to a number of authorities. Lloyds continue to offer competitive rates, though they are gradually reducing and the Council will make maximum use of this institution until such time as their status changes. A large percentage of funds will be kept in reserve accounts, deposit accounts and money market funds for liquidity purposes.

84 Should the Council invest for periods of over 364 days a limit of 25% of total investments will apply. The Council is asked to approve the following indicators:

Maximum percentage of outstanding investments >364 days	2014/15	2015/16	2016/17
	25%	**25%**	**25%**

Investment Defined as Capital expenditure

85 The acquisition of share or loan capital in any corporate body is defined as capital expenditure under section 16(2) of the Local Government Act 2003. Such investments will have to be funded from capital or revenue resources and be classified as non-specified investments.

86 Any loan or grant to another body for capital expenditure by that body will also be deemed , by regulation, to be capital expenditure by the Council. This includes loans to London Luton Airport Limited. It is therefore important for the Council to clearly identify if the loan or grant has been made for policy reasons or it is an investment for treasury management purposes in which case it would be governed by the framework set for specified and non specified investments.

Treasury Policy Statement

87 The Council's treasury policy statement is shown at Appendix C.

Provision for Credit – Related Losses

88 If any of the Council's investments appeared to be at risk or of loss to default (i.e. a credit-related loss rather than a loss due to a fall in price or movement in interest rates) the Council will make a revenue provision of an appropriate amount.

External Fund Managers

89 At present the Council does not employ the services of an external fund manager. This is kept under review and if the Council's treasury advisors suggest that an external fund manager can provide better value, net of fees, for a proportion of the Council's investments, then the Council will consider this.

Large Scale Voluntary Transfer (LSVT)

90 Any potential transfer will have treasury management implications and these would need to be considered by the Executive if the situation ever arises.

Other Issues

91 Specific consideration is given to funding PFI arrangements, as approved by the relevant Government department and H.M Treasury. The treasury management implications of PFI arrangements need to be fully considered by the Executive

Key Risks

Treasury Management is an area of significant risk. In relation to security and probity of investments all activity has been undertaken in accordance with the provisions of the Council's Treasury Management Practices (TMP's) which include a substantial section on risk, ion order to manage and minimise , so far as possible, the risks involved.

Appendices and additional background papers attached:

Appendices - A-C

IMPLICATIONS

		Clearance – agreed by:
Legal	Save for those set out in the body of the report, there are no direct legal implications to this report.	Principal Solicitor (Litigation) 22.01.15
Finance	The financial implications are included in the body of	Head of Finance

	the report’	21.01.15
Equalities/ Cohesion/Inclusion (Social Justice)	The report has no direct or indirect equality, cohesion or inclusion implications except as far as it reports on investments and borrowings which may directly or indirectly have implications dependant upon how those investments are managed and how that borrowing is used	Social Justice Adviser 21.01.15
Environment	The report has no direct or indirect environmental implications except as far as it reports on investments and borrowings which may directly or indirectly have implications dependant upon how those investments are managed and how that borrowing is used	Strategy & Sustainability Manager on the 21.01.15
Health	The report has indirect implications for public health as far as it reports on investments and borrowings which may have indirect implications on the council’s responsibility for health and wellbeing, dependent upon how those investments are managed and how that borrowing is used	Kelly O’Neill – AD Public Health 22.01.15

FOR EXECUTIVE ONLY - Options:

Executive can approve the strategy, amend the strategy, or ask for the strategy to be reformulated.