ISLE OF ANGLESEY COUNTY COUNCIL

REPORT TO:	**COUNTY COUNCIL**
DATE:	**26 FEBRUARY 2015**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY STATEMENT 2015/16**
PORTFOLIO HOLDER:	**COUNCILLOR H E JONES**
LEAD OFFICER:	**RICHARD MICKLEWRIGHT**
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Nature and reason for reporting

The Council is required to implement best practice in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management which recommends that, prior to being presented for adoption, Members should scrutinise the Treasury Management Strategy Statement (TMSS) (which includes the Annual Investment Strategy, the annual MRP Policy Statement, the annual Treasury Management Policy Statement and the Treasury Management Scheme of Delegation). This Authority's Treasury Management Scheme of Delegation (TMSD) charges the Audit Committee with this function. The TMSD also requires the Executive to receive and review the TMSS prior to it being presented to the full Council for approval. This report runs alongside the capital and revenue budget reports as part of the 2015/16 budget setting process.

A - Recommendation/s and reason/s

1. This report and Annex (as detailed in the section above, sections 3 to 6 below and including Annex A) was presented to the Audit Committee on 9 February 2015. That Committee resolved to:-

- Note the contents of the covering report; and
- Endorse the Treasury Management Strategy Statement (including the Prudential and Treasury Management Indicators) for 2015/16 (Annex A to this report).

The Audit Committee did not resolve to pass any comments or recommendations on to the Executive Committee.

2. This report and Annex (as detailed in the section above, sections 3 to 6 below and including Annex A) was presented to the Executive Committee on 16 February 2015. That Committee resolved to:-

- Note the contents of the covering report; and
- Endorse the contents of, and assumptions and proposals made within, the Treasury Management Strategy Statement (including the Prudential and Treasury Management Indicators) for 2015/16 (Annex A to this report).

The Executive Committee did not resolve to pass on any comments or recommendations.

3. The CIPFA Code of Practice on Treasury Management (Section 7) recommends that the Authority's Treasury Management Practices should be approved, documented and monitored. It goes on to state that the nature and extent of the involvement of an organisation's responsible body in approving and monitoring its TMPs and accompanying schedules is a matter for local decision and recognises that in some organisations this may be delegated to the responsible officer. In all cases it should be subjected to scrutiny by the responsible body following recommendations by the responsible officer. This Authority does not currently have documented TMPs but it is intended that this will be resolved in 2015/16 and presented at the earliest opportunity to the relevant committees, in line with the proposed Treasury Management Scheme of Delegation for 2015/16.

4. In terms of updates to the Treasury Management Strategy Statement there is only one proposed amendment to the core principals and policies of the 2014/15 Statement, which is as follows:-

- The quarter one and quarter three Treasury Management reports will no longer be produced. This is to be reflected within the Authority's standing orders, as detailed in Appendix 9 to this report.

It is intended that the potential categories of investments to be used, together with the credit rating criteria and investment limits, will be subject to review during the year with any amendments subject to prior approval in accordance with the Treasury Management Scheme of Delegation.

5. The planned exit of the HRA subsidy system on 2 April 2015 has been taken into account in the prudential indicators (see Appendix 11) on the basis set out in Appendix 12 (within which the wording has been slightly expanded and amended for this report to improve clarity).

6. The Council's external borrowing stood at £89.6m as at 2 February 2015, this is expected to be the position at 31 March 2015. The borrowing is made up of maturity and annuity loans. The maturity loans stood at £89.3m with an average life of 25 years, and average interest rate of 5.70%. The annuity loans stood at £0.3m with average life of 10 years and an average interest rate of 9.41%. The anticipated cost of borrowing for 2014/15 is £5.1m and the forecast underlying need to borrow at the year end is £114.8m. This means that the Council will be internally borrowed by £25.2m by the year end.

The Council's investments as at 2 February 2015 stood at £16.1m with an average rate of return of 0.4% and the average balance for the year to date is £21.1m. As internal borrowing has increased the investment balances have decreased.

7. Recommendations:-

7.1 To note the contents of the covering report.

7.2 To approve the 2015/16 Treasury Management Strategy Statement (which includes the annual Investment Strategy, MRP Policy, annual Treasury Management Policy Statement and the Prudential and Treasury Indicators).

B - What other options did you consider and why did you reject them and/or opt for this option

n/a

C - Why is this a decision for the Council?

To comply with this Authority's budget setting process and Treasury Management Scheme of Delegation.

CH - Is this decision consistent with policy approved by the full Council?

Yes

D - Is this decision within the budget approved by the Council?

Yes

DD - Who did you consult?		**What did they say?**
1	**Chief Executive / Strategic Leadership Team (SLT)** (mandatory)	
2	**Finance / Section 151** (mandatory)	n/a – this is a S151 Officer report
3	**Legal / Monitoring Officer** (mandatory)	
4	**Human Resources (HR)**	
5	**Property**	
6	**Information Communication Technology (ICT)**	
7	**Scrutiny**	
8	**Local Members**	
9	**Any external bodies / other/s**	

E -	**Risks and any mitigation (if relevant)**		
	1	**Economic**	
	2	**Anti-poverty**	
	3	**Crime and Disorder**	
	4	**Environmental**	
	5	**Equalities**	
	6	**Outcome Agreements**	
	7	**Other**	
F -	**Annexes:**		

Annex A: Draft Treasury Management Strategy Statement and Prudential and Treasury Indicators for 2015/16.

FF - Background papers (please contact the author of the Report for any further information):

- Treasury Mangement Strategy Statement 2014/15 (as approved by the Council on 27 February 2014);
- Capital and revenue 2015/16 budget setting papers (as seperately reported to this Committee).

ANNEX A

TREASURY MANAGEMENT STRATEGY STATEMENT

ANNUAL INVESTMENT STRATEGY, MINIMUM REVENUE PROVISION POLICY STATEMENT AND TREASURY MANAGEMENT POLICY STATEMENT 2015/16

1. Introduction

1.1 Background

The Council is required to operate a balanced budget, meaning that total revenue due during the financial year must be sufficient to meet expenditure, and also that actual cash inflows must be adequate to cover cash outflows. A key part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk approach, ensuring adequate liquidity before considering investment return.

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

A particular point is that a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that:-

- increases in revenue costs resulting from increases in interest charges, incurred to finance additional borrowing to finance capital expenditure; and
- any increases in running costs from new capital projects, must be limited to a level which is affordable within the Council's projected income.

The Treasury Management Policy Statement defines the policies and objectives of the treasury management activities. See Appendix 10.

1.2 Reporting Requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit Committee.

Prudential and Treasury Management Indicators and Treasury Strategy - The first and most important report, covers:-

- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury management indicators;
- an Investment Strategy (the parameters on how investments are to be managed);
- a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);
- a Treasury Management Policy Statement (definition of the policies and objectives of the treasury management function); and
- the capital plans (including the associated prudential indicators).

A Mid Year Treasury Management Report - This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting its objectives or whether any policies require revision.

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

1.3 Treasury Management Strategy for 2015/16

The strategy for 2015/16 covers two main areas:-

Capital Issues

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

Treasury management Issues

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

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. In order to support the scrutiny role of the members of the Audit Committee, the committee's members received training in treasury management, delivered by the appointed treasury management consultants on 14th July 2014. Further training will be arranged as required.

The training needs of treasury management officers are regularly reviewed and addressed.

1.5 Treasury management consultants

The Council uses Capita Asset Services, – Treasury Solutions (herein referred to as Capita)as its external treasury management advisors.

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

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

1.6 Adoption of the Code

The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The current, 2011, code of practice has already been adopted by this Council and so no update is required for 2015/16.

2. Capital Considerations

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

The Authority's capital expenditure projections for 2015/16 to 2017/18 are reflected in the Prudential Indicators (Appendix 11). The projected expenditure for 2015/16 to 2017/18 is based on the capital bids recommended for approval in accordance with the 2015/16 Capital Strategy, as separately reported. The projections for those years also include the assumption that slippage from 2014/15 with be fully spent in 2015/16. The 2015/16 expenditure forecast includes the projected HRA self-financing settlement as detailed below.

Subject to the voluntary agreement of all 11 of the Welsh housing authorities the Council will be required to make a one off payment to the Welsh Government to remove the HRA from the current housing subsidy system. The payment is expected to be in the region of £21.4m although this could change. This one off payment is compensation, ensuring the HRA will no longer make future annual payments to the Welsh Government. It is expected that the overall impact will be beneficial to the Council. The final settlement amount is to be confirmed but by agreeing to the revised prudential indicators the Council is ensuring the necessary local requirements are in place well before the payment is required.

The overall programmes will be limited to what is affordable, both in terms of actual capital spend and in terms of the revenue implications (see 1.1 above). The prudential indicators are contained in Appendix 11.

3. Borrowing

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

3.1 Current and Projected Borrowing Requirement and Actual Borrowing

The forecast movements in the Council's capital financing requirement (CFR) are:-

ESTIMATED MOVEMENTS IN THE CAPITAL FINANCING REQUIREMENT AND REPLACEMENT BORROWING 2014/15 TO 2017/18				
	2014/15 Projected £'000	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Movement in the CFR				
New borrowing to support capital expenditure				
Supported Borrowing	*4,472*	*2,750*	*2,189*	*2,189*
Unsupported Borrowing	*6,000*	*23,400*	*4,620*	*0*
Total	**10.472**	**26,150**	**6,809**	**2,189**
Reduce by: Minimum Revenue Provision and set aside capital receipts	(4,538)	(4,287)	(4,801)	(4,908)
Net movement in the CFR	**5,934**	**21,863**	**2,008**	**(2,719)**
Potential movements in actual borrowing				
Movement in the CFR (above)	-	21,863	2,008	(2,719)
Externalisation of pre 2013/14 internal borrowing	-	25,177	-	-
Replacement Borrowing	-	8	9	5,509
Total potential new borrowing	**-**	**47,048**	**2,017**	**2,790**

3.2 Prospects for Interest Rates

The Council's appointed treasury advisor is Capita Asset Services and part of their service is to assist the Council to formulate a view on interest rates. Appendix 3 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita central view.

Annual Average (%)	**Bank Rate (%)**	**PWLB Borrowing Rates (including certainty rate adjustment)**		
		5 year	**25 year**	**50 year**
March 2015	0.50	2.20	3.40	3.40
June 2015	0.50	2.20	3.50	3.50
September 2015	0.50	2.30	3.70	3.70
December 2015	0.75	2.50	3.80	3.80
March 2016	0.75	2.60	4.00	4.00
June 2016	1.00	2.80	4.20	4.20
September 2016	1.00	2.90	4.30	4.30
December 2016	1.25	3.00	4.40	4.40
March 2017	1.25	3.20	4.50	4.50
June 2017	1.50	3.30	4.60	4.60
September 2017	1.75	3.40	4.70	4.70
December 2017	1.75	3.50	4.70	4.70
March 2018	2.00	3.60	4.80	4.80

UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid-2015.

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

- Greece: the general election on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;

- As for the Eurozone in general, concerns in respect of a major crisis 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 as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2015/16 and beyond;

- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt; and

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

3.3 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This approach is prudent as investment returns are low and counterparty risk is high, and will continue to be followed where appropriate (see 3.3.1 below for a more detailed consideration of internal and external borrowing).

Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The S151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:-

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

- If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a faster than currently anticipated unwinding of quantitative easing in the US, or an unexpected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

HRA reform in Wales

The requirement for the HRA reform settlement to be made to the Welsh Government on 2 April 2015 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount available on the 2 April 2015, and this must be funded by way of borrowing from the Public Works Loans Board (PWLB) loans and so separate borrowing solely for this purpose will be incurred. The exact structure of loans to be drawn is currently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council.

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

3.3.1 External v. internal borrowing

Current conditions indicate a need for a flexible approach to the choice between internal and external borrowing. Many of the factors which lay behind previous policies to externalise all borrowing remain valid, e.g.:-

- With a continuing historically abnormally low Bank Rate and PWLB rates, there remains a unique opportunity for local authorities to actively manage their strategy of undertaking new external borrowing.

However, it remains the case that there are certain limitations to this approach, as previously noted, e.g.:-

- The policy can cause exposure to credit risk (e.g. risk of the bank defaulting on the debt), so this aspect must be very carefully managed;
- Careful on going consideration needs to be given to the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

In favour of internalisation, over the medium term investment rates are expected to continue to be below long term borrowing rates. This means that value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure, or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

However, short term savings by avoiding new long term external borrowing in 2014/15 must also be weighed against the potential for incurring additional long term extra costs, by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher. Additionally, the cash flow implications of internalising borrowing require regular review and will limit the potential extent of internalising borrowing.

The HRA subsidy system exit could provide an opportunity to take up long dated PWLB loans at historically low levels to benefit the Council as a whole over the long term. Any such strategy will be subject to review in the weeks leading up to the anticipated exit (see Section 3.4).

Against this background, caution will be adopted with the 2015/16 treasury operations. The S151 Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the earliest opportunity.

3.4 Policy on borrowing in advance of need

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

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

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

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

3.5 Debt Rescheduling

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

The reasons for any rescheduling to take place will include:-

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

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

All rescheduling will be reported to the Audit Committee, at the earliest practicable meeting following its action.

4. Annual Investment Strategy

4.1 Investment Policy

The Council's investment policy has regard to the Welsh Government's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice for Local Authorities and Cross-Sectorial Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

In accordance with the above guidance from the Welsh Government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

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 fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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

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

Investment instruments identified for use in the financial year are listed in Appendix 5 under the ‘specified’ and ‘non-specified’ investments categories.

The Council will also from time to time, make loans, deposits and investments ‘for the purpose of delivery of its Service’s (policy investments). These transactions will require the authority of the County Council for amounts over £100k. All transactions will be subject to adequate credit quality and the approval of the Section 151 Officer in consultation with the Portfolio Holder for Finance.

4.2 Creditworthiness policy

The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:-

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

The S151 Officer will maintain a counterparty list in compliance with the criteria set out in Appendix 6 and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution (using the Fitch, Moody's and Standard & Poor's credit rating agencies). For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution, on the basis of credit rating, will fall outside the lending criteria. Credit rating information is supplied by Capita Assets Services on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria could be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

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

As an additional layer to the minimum credit rating criteria described above, this Council also employs the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-

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

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads from which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council at the discretion of the S151 Officer, to assist in determining the duration for investments. The Council will, therefore, normally use counterparties within the following durational bands:-

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

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

Reference will also be made to other market data and market information, as available and as appropriate.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 7. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

4.4 Investment Strategy

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

Investment returns expectations: Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:-

- 2015/16 0.75%
- 2016/17 1.25%
- 2017/18 2.00%

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

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

2015/16 0.60%
2016/17 1.25%
2017/18 1.75%
2018/19 2.25%
2019/20 2.75%
2020/21 3.00%
2021/22 3.25%
2022/23 3.25%
Later years 3.50%

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

4.5 End of year investment report

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

4.6 External fund managers

The Council has not appointed external fund managers. The need for this will be kept under review and a reported as appropriate before such an appointment is made.

4.7 Policy on the use of external service providers

In order to acquire access to specialist skills and resources, the Council uses Capita Assets Services as its external treasury management advisors. 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.

Final responsibility for treasury management decisions remains with the Council.

4.8 Delegation

The Treasury Management scheme of delegation and the role of the Section 151 Officer are outlined in Appendix 8.

APPENDICES

1. Loan maturity profile
2. MRP Policy Statement
3. Interest rate forecasts
4. Economic background
5. Specified and non-specified investments
6. Counterparty criteria
7. Approved countries for investments
8. Treasury management scheme of delegation and the role of the section 151 officer.
9. Treasury Management Key Principles
10. Treasury Management Policy Statement
11. Prudential and Treasury Indicators
12. Glossary of and information on Prudential & Treasury Management indicators

DADANSODDIAD BENTHYCIADAU YN AEDDFEDU 2014/15 YMLAEN/ LOANS MATURITY ANALYSIS 2014/15 ONWARDS						
	PWLB Aeddefedu/ PWLB Maturity £'000	**PWLB EIP/ Annuity/ PWLB EIP/ Annuity £'000**	**Benthyciadau Marchnad/ Market Loans £'000**	**PWLB Amrywiol/ PWLB Variable £'000**	**Cyfanswm yn Aeddfedu/ Total Maturing £'000**	**%YN Aeddfedu o'r Cyfran yn sefyll/ Maturing of Total Outstanding %**
2014/15	0	1	0	0	1	0.0
2015/16	0	8	0	0	8	0.0
2016/17	0	9	0	0	9	0.0
2017/18	5,500	9	0	0	5,509	6.2
2018/19	5,000	10	0	0	5,010	5.6
2019/20	5,000	11	0	0	5,011	5.6
2020/21	4,500	12	0	0	4,512	5.0
2021/22	0	14	0	0	14	0.0
2022/23	2,285	15	0	0	2,300	2.6
2023/24	1,854	16	0	0	1,870	2.1
2024/25	0	18	0	0	18	0.0
2025/26	0	20	0	0	20	0.0
2026/27	854	22	0	0	876	1.0
2027/28	1,674	24	0	0	1,698	1.9
2028/29	0	26	0	0	26	0.0
2029/30	854	21	0	0	875	1.0
2030/31	0	15	0	0	15	0.0
2031/32	1,281	9	0	0	1,290	1.4
2032/33	0	8	0	0	8	0.0
2033/34	0	0	0	0	0	0.0
2034/35	0	0	0	0	0	0.0
2035/36	0	0	0	0	0	0.0
2037/38	0	0	0	0	0	0.0
2039/40	5,000	0	0	0	5,000	5.6
2040/41	3,500	0	0	0	3,500	3.9
2045/46	0	0	0	0	0	0.0
2047/48	0	0	0	0	0	0.0
2050/51	2,000	0	0	0	2,000	2.2
2052/53	28,238	0	0	0	28,238	31.5
2054/55	3,000	0	0	0	3,000	3.3
2055/56	3,500	0	0	0	3,500	3.9
2056/57	5,000	0	0	0	5,000	5.6
2057/58	8,513	0	0	0	8,513	9.6
2059/60	1,763	0	0	0	1,763	2.0
2060/61	0	0	0	0	0	0
	89,316	**268**	**0**	**0**	**89,585**	**100.0**
Cyfartaledd bywyd (blynyddoedd)/ Average life(years)	25.43	10.41	0.00	0.00	25.38	
Cyfartaledd graddfa (%)/ Average rate (%)	5.70	9.41	0.00	0.00	5.72	

Minimum Revenue Provision Policy Statement 2015/16

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

The Welsh Government regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

For capital expenditure incurred before 1 April 2008 or for capital expenditure from 1 April 2008 financed supported capital expenditure for Revenue Support Grant purposes, the MRP policy will be to charge 4% of the CFR at the end of the preceding year (in accordance with option 2 of the statutory guidance).

From 1st April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be the Asset Life method, with the MRP based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (in accordance with option 3 of the statutory guidance). The estimated life periods will be set by the S151 Officer based upon advice received from the relevant officers.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The Housing Revenue Account share of the CFR is subject to a 2% MRP charge, based upon the closing CFR for the previous year, in line with the approved 30 year business plan.

Any repayments included in annual PFI or finance leases are applied as MRP.

Rhagolygon Graddfeydd Llog 2015/2018/
Interest Rate Forecasts 2015/2018/

Capita Asset Services Interest Rate View													
	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
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-
Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012													

Rhan o gyngor dderbyniwyd gan / An extract from advice received from: Capita Asset Services

Economic Background

THE UK ECONOMY

Economic growth, After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

THE GLOBAL ECONOMY

Eurozone (EZ): The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011/2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

Greece: the general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA: The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

China: Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan: Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

Capital Asset Services forward view:

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:-

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

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

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.
- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Rhan o gyngor dderbyniwyd gan / An extract from advice received from: Capita Asset Services

Specified and Non-Specified Investments

The Welsh Government 'Guidance on Local Government Investments' (Effective from 1 April 2010) provides the definition of specified and non-specified investments.

Paragraph 5.1 of the 'Guidance' states that an investment is specified if all of the following apply:-

(a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling; and

(b) the investment is not a long-term investment (*); and

(c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]; and

(ch) the investment is made with a body or in an investment scheme of high credit quality (**); or with one of the following public-sector bodies:

- **(i)** the United Kingdom Government
- **(ii)** a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
- **(iii)** a parish or community council.

The 'Guidance' also states that any investment not meeting the definition of paragraph 5.1 is classified as a non-specified investment.

During 2015/16 the Council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation (such as company shares). Non-specified investments will therefore be limited to (i) long-term investments; and (ii) deposits with the Council's own banker for transactional purposes if it fails to meet the basic credit criteria; in this instance balances will be minimised as far as is possible

The table in Appendix 6 set out the investment criteria and limits for the categories of investments intended for use during 2015/16 and therefore form the basis for the approved lending list.

Any proposed revisions or amendments during the year to the categories of specified and non-specified investments to be used and / or to the associated credit rating criteria / investment limits will be subject to prior approval by the County Council.

***** *Section 2.4 of the 'Guidance' defines a long term investment as ''any investment other than (a) one which is due to be repaid within 12 months of the date on which the investment was made or (b) one which the local authority may require to be repaid within that period.''*

****** *For the purposes of high credit quality the 'Guidance' states that ''for the purposes of paragraph 5.1(d), Welsh ministers recommend that the Strategy should define high credit quality (and where this definition refers to credit ratings, paragraph 6.1 (***) is relevant).'*

*** *Paragraph 6.1 of the 'Guidance' recommends that ''the Strategy should set out the authority's approach to assessing the risk of loss of investments, making clear in particular:*
- ***(a)*** *to what extent, if any, risk assessment is based upon credit ratings issued by one or more credit rating agencies;*
- ***(b)*** *where credit ratings are used, how frequently credit ratings are monitored and what action is to be taken when ratings change; and*
- ***(c)*** *what other sources of information on credit risk are used, additional to or instead of credit ratings.''*

The table in Appendix 6 of this strategy sets out what this Council defines as high credit quality and the associated investment criteria and limits and section 4.2 of this strategy sets out the Council's creditworthiness approach.

Counterparty Criteria

Category	Short Term Credit Rating (Fitch)	Short Term Credit Rating (Moody's)	Short Term Credit Rating (Standard & Poor's)	Long Term Credit Rating (Fitch)	Long Term Credit Rating (Moody's)	Long Term Credit Rating (Standard & Poor's)	Cash Limit	Time Limit
Banks and Building Societies (not nationalised or part nationalised)	**F1+**	**P-1**	**A-1+**	**AAA**	**Aaa**	**AAA**	**£10m**	**5 years**
	F1+	**P-1**	**A-1+**	**AA**	**Aa2**	**AA**	**£10m**	**3 years**
	F1+	**P-1**	**A-1+**	**AA-**	**Aa3**	**AA-**	**£10m**	**364 days**
	F1	**P-1**	**A-1**	**A**	**A2**	**A**	**£7.5m**	**6 months**
Nationalised / Part Nationalised UK Banks	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**£10m**	**364 days**
UK Central Government (irrespective of credit rating)	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**No maximum**	**No maximum**
UK Local Authorities**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**£5m**	**364 days**

* *as defined in the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003*

****** *as defined in the Local Government Act 2003*

<u>Notes and Clarifications</u>

(1) <u>Cash Limit</u>

(i) The cash limits apply both to the individual counterparty and to the overall group to which it belongs (e.g. for the banks within the Lloyds Banking Group plc (being Bank of Scotland plc and Lloyds Bank plc), the investment limit applies to those banks individually and the banking group as a whole);

(ii) The overall cash limit for deposits over 364 days is £15m.

(2) <u>Time Limit</u>

(i) This up to and including the period indicated.

(3) <u>Foreign Countries</u>

(i) Investments in foreign countries will be limited to those that hold a sovereign credit rating of (Fitch) AA- or equivalent (from the agencies referred to in section 4.3 of this strategy) sovereign credit rating (based upon the lowest common denominator), and to a maximum of £10 million per foreign country.

(ii) Investments in countries whose lowest sovereign rating is not AA- or above will not be permitted. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.

(iii) Subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to its substantial UK franchises and the arms-length nature of the parent-subsidiary relationships.

(iv) Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

4. <u>Credit Rating Downgrade</u>

Should a credit rating downgrade place a counterparty below the minimum credit rating criteria for investment, the counterparty will cease to be used as soon as practicable.

If the S151 Officer wishes to continue investing with that counterparty approval will be sought from the Chair of the Audit Committee plus one other member of the Chair's choosing, who both must approve the action. This will then be reported as appropriate at the next available opportunity.

Approved countries for investments [correct as at 27 January 2015]

Based upon lowest available sovereign credit rating

AAA

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

AA+

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

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium
- Saudi Arabia

Treasury management scheme of delegation

(i) County Council

- budget approval;
- approval of the annual Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy, annual Treasury Management Policy Statement and amendments thereto;
- approval of amendments to the Council's adopted clauses;
- receiving and reviewing monitoring reports on treasury management policies, practices and activities; and
- acting on recommendations received from the Audit Committee and/or Executive Committee.

(ii) Executive Committee

- budget consideration;
- approval of the annual Treasury Management Practices and amendments thereto;
- approval of the division of responsibilities;
- approval of the selection of external service providers and agreeing terms of appointment;
- receiving and reviewing monitoring reports on treasury management policies, practices and activities and making recommendations to the County Council as appropriate;
- acting on recommendations received from the Audit Committee.

(iii) Audit Committee

- Scrutiny of Treasury Management matters as required by CIPFA's Cod of Practice on Treasury Management and the Council's Treasury Management Policy. This includes:-

  - scrutinising the annual Treasury Management Strategy Statement, Annual Investment Strategy, Annual MRP Policy, Annual Treasury Management Policy and Treasury Management Practices and making recommendations to the Executive Committee and County Council as appropriate;
  - scrutinising proposals for amendments to the annual Treasury Management Strategy Statement, Annual Investment Strategy, Annual MRP Policy, Annual Treasury Management Policy and Treasury Management Practices and to the adopted clauses and making recommendations to the Executive and County Council as appropriate;
  - receiving and scrutinising any other proposals relating to the treasury management which require a decision by the Executive or County Council; and
  - receiving and scrutinising monitoring reports on treasury management policies, practices and activities and make recommendations to the Executive and County Council as appropriate.

The treasury management role of the section 151 officer

The S151 (responsible) officer's role includes:-

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit; and
- recommending the appointment of external service providers.
- Responsibility for the execution and administration of its Treasury decisions, including decision on borrowing, investment and financing, have been delegated to the Section 151 Officer, who will act in accordance with the Council's policy statements and TMP's.

The CIPFA Treasury Management in the Public Services: Code of Practice

The key principles of CIPFA's ***Treasury Management in the Public Services: Code of Practice (2011 Edition)***, as described in Section 4 of that Code are as follows:-

Key Principle 1:
Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

Key Principle 2:
Their policies and practices should make clear that the effective management and control of risks are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

Key Principle 3:
They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that, within the context of effective risk management, their treasury management policies and practices should reflect this.

The Code then goes on to say that:

"In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, whilst at the same time pursuing value for money. This code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function."

"Even though it dates back to 1991, CIPFA considers that the report by the Treasury and Civil Service Committee of the House of Commons on the BCCI closure is still pertinent, wherein it was stated that:"

"In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns."

"Indeed this view was supported by the Communities and Local Government Select Committee report into local authority investments in 2009."

"It is CIPFA's view that throughout the public services the priority is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money."

Accordingly the Authority will adopt, as part of the standing orders, the following four clauses;

1. The Authority will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and

- suitable treasury management practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the Policy Statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments will not result in the Authority materially deviating from the Code's key principles.

2. The County Council, Executive Committee and the Audit Committee will receive reports on the Authority's treasury management policies, practices and activities, including; an annual strategy and plan in advance of the year, a mid-year review report and an annual report after its close, in the form prescribed in the TMPs. .

3. The County Council/Executive Committee are responsible for the implementation of the Authority's treasury management policies and practices in accordance with the Treasury Management Scheme of Delegation. The S151 Officer is responsible for the execution and administration of treasury management decisions, who will act in accordance with the Authority's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. The Authority nominates Audit Committee to be responsible for ensuring effective scrutiny of treasury management strategy and policies.

Treasury Management Policy Statement

1. The Authority defines its treasury management activities as: “The management of the 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’’.

2. This organisation 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 focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

3. This organisation 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 value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

APPENDIX 11

No.	PRUDENTIAL & TREASURY INDICATORS BUDGET SETTING 2015/16 — Indicator	2013/14 out-turn	2014/15 estimate	2015/16 proposal	2016/17 proposal	2017/18 proposal
Affordability						
1,2	Estimates of [or actual] ratio of financing costs to net revenue stream:					
	Council Fund	5.54%	5.90%	6.53%	6.64%	6.34%
	Housing Revenue Account (inclusive of settlement)	16.40%	13.32%	21.09%	23.76%	22.27%
	Total	6.55%	6.62%	8.06%	8.59%	8.30%
3	Estimates of incremental impact of capital investment decisions on the Council Tax			£2.95	£16.31	£22.11
	for the Band D Council Tax					
4	Estimates of incremental impact of capital investment decisions on housing rents			£29.17	£43.63	£25.20
	on average weekly rent levels					
Prudence						
5	Gross debt and the Capital Financing Requirement (CFR)	✓	✓	✓	✓	✓
	Is the gross external debt < the CFR for the preceding year plus the estimates of any additional CFR for the current and the next two financial years?					
Capital Expenditure		**£000**	**£000**	**£000**	**£000**	**£000**
6,7	Estimates of [or actual] capital expenditure					
	Council Fund	19,571	20,410	15,520	6,500	4,600
	Housing Revenue Account	3,169	6,000	8,590	11,900	7,700
	Total	22,740	26,410	24,110	18,400	12,300
8,9	Estimates of [or actual] Capital Financing Requirement					
	Council Fund	84,923	91,866	92,787	93,000	91,200
	Housing Revenue Account	23,903	22,894	43,836	45,600	45,700
	Total	108,825	114,760	136,623	138,600	136,900
External Debt		**£000**	**£000**	**£000**	**£000**	**£000**
10	Authorised Limit					
	: General Borrowing	123,000	125,000	126,000	128,000	126,000
	: HRA Settlement	0	0	36,000	36,000	36,000
	: Other long term liabilities	2,000	2,000	3,000	3,000	3,000
	: Total	125,000	127,000	165,000	167,000	165,000

11	HRA Limit on Indebtedness;					
	HRA Limit on Indebtedness	n/a	n/a	58,780	58,780	58,780
	HRA CFR	n/a	n/a	43,836	45,600	45,700
	HRA headroom	n/a	n/a	14,944	13,180	13,080
12	Operational Boundary					
	: General Borrowing	118,000	120,000	121,000	123,000	121,000
	: HRA Settlement	0	0	36,000	36,000	36,000
	: Other long term liabilities	2,000	2,000	3,000	3,000	3,000
	: Total	120,000	122,000	160,000	162,000	160,000
13	Actual External Debt	89,585				
Treasury Management		**2013/14 out-turn**	**2014/15 estimate**	**2015/16 proposal**	**2016/17 proposal**	**2017/18 proposal**
14	The Local Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services	✓	✓	✓	✓	✓
		£000	**£000**	**£000**	**£000**	**£000**
15	Gross and net debt	100%	100%	100%	100%	100%
	The upper limit on the net debt as a proportion of gross debt					
16	The upper limit on fixed rate exposures:	105,000	125,000	162,000	164,000	162,000
	(net principal outstanding)					
17	The upper limit on variable rate exposures:	20,000	20,000	20,000	20,000	20,000
	(net principal outstanding)					
18	The limit for total principal sums invested for periods longer than 364 days	15,000	15,000	15,000	15,000	15,000
	(any long term investments carried forward from previous years will be included in each year's limit)					

			2015/16 upper limit	**2015/16 lower limit**
19	The upper and lower limits for the maturity structure of fixed rate borrowing			
	• under 12 months		20%	0%
	• 12 months and within 24 months		20%	0%
	• 24 months and within 5 years		50%	0%
	• 5 years and within 10 years		75%	0%
	• 10 years and above		100%	0%
			no change	no change

Glossary of and information on Prudential & Treasury Management indicators (References as per appendix 11)

Prudential Indicators

A) Affordability

1,2 Ratio of financing costs to net revenue stream

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

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

The HRA indicators (reference 2) reflect the forecast HRA self-financing settlement; this forecast settlement is based upon the figures provided by the Welsh Government during consultations (the figure being £21.4m based on a borrowing rate of 4.2%). As reported, this figure could change.

3. Incremental impact of capital investment decisions on council tax

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

4. Estimates of the incremental impact of capital investment decisions on housing rent levels

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

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

It should be noted that this indicator does not reflect the forecast HRA self-financing settlement.

B) Prudence

5. Gross Debt and the CFR

The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

C) Capital expenditure

7. Estimates of Capital Expenditure (HRA)

The HRA indicator (reference 7) does not reflect the forecast HRA self-financing settlement; the forecast settlement is based upon the figures provided by the Welsh Government during consultations (the figure being £21.4m based on a borrowing rate of 4.2%) . As reported, this figure could change and so will be included once confirmed.

8,9 The Council's borrowing need (the Capital Financing Requirement)

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

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

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £nil of such schemes within the CFR.

The HRA indicators (reference 9) reflect the forecast HRA self-financing settlement; this forecast settlement is based upon the figures provided by the Welsh Government during consultations (the figure being £21.4m based on a borrowing rate of 4.2%). As reported, this figure could change.

CH) External Debt

10. **The authorised limit for external debt**. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

    This indicator reflects the potential upper limit on the HRA self-financing settlement value (£35.8m); the potential upper limit for the HRA settlement is what is considered to be the breakeven point for the HRA self-financing reform to be financially advantageous.

    The S151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

11. **HRA Limit on Indebtedness.** As part of the HRA self-financing reform each Welsh local authority with responsibility for housing will be allocated a limit on indebtedness in relation to the HRA; this essentially places a limit on the HRA CFR (to be applied at 31st March each year). The gap between the two, if the CFR is within the limit, will be referred to as the borrowing headroom. The forecast accounts for the HRA settlement on the same basis as for the ratio in reference 2.

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

This indicator reflects the potential HRA self-financing settlement value on the same basis as for the Authorised Limit indicator.

<u>Treasury Management Indicators</u>

Treasury management limits on activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates; and
- 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.