Council **4th February 2014**

Treasury Management Strategy Statement and Annual Investment Strategy
Mid-year Review Report 2014/15

Portfolio Holder: Councillor Abdul Jabbar- Cabinet Member, Finance and Human Resources

Report of the Interim Borough Treasurer

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4th February 2014

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Purpose of Report

The report advises Council of the performance of the Treasury Management function of the Council for the first half of 2014/15, and provides a comparison of performance against the 2014/15 Treasury Management Strategy and Prudential Indicators.

Executive Summary

Council is required to consider the performance of the Treasury Management function in order to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Revised Code of Practice. This report therefore sets out the key Treasury Management issues for Members' information and review and outlines:

- An economic update for the first six months of 2014/15;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2014/15;
- A review of the Council's borrowing strategy for 2014/15;
- Why there has been no debt rescheduling undertaken during 2014/15;

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- A review of compliance with Treasury and Prudential Limits for 2014/15.
- An explanation of changes to the credit rating methodology used by Capita Asset Services, the Authority's current treasury management advisers

The report was considered and approved at the Cabinet meeting on 15th December 2014 and will be presented to the next meeting of the Audit Committee

Recommendations

Council is requested to:

1) Approve the Treasury Management activity for the first half of the financial year 2014/15 and the projected outturn position

2) Approve the amendments to both Authorised and Operational Boundary for external debt as set out in the table at Section 2.4.5 of the report.

3) Approve the changes to the credit methodology whereby viability, financial strength and support ratings will no longer be considered as key criteria in the choice of creditworthy investment counterparties.

Council **4th February 2014**

Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2014/15

1 Background

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

1.2 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 the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 As a consequence treasury management is defined 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. "

2 Current Position

2.1 Requirements of the Treasury Management Code of Practice

2.1.1 The Council adopted the revised Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) on 23rd February 2011.

2.1.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives

c) Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review**

Report and an Annual Report (stewardship report) covering activities during the previous year

d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. In Oldham, this responsibility is delegated to the Borough Treasurer (Interim).

e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee.

2.1.3 This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2014/15;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2014/15;
- A review of the Council's borrowing strategy for 2014/15;
- Why there has been no debt rescheduling undertaken during 2014/15;
- A review of the compliance with Treasury and Prudential Limits for 2014/15;
- An explanation of changes to the credit rating methodology used by Capita Asset Services, the Authority's current treasury management advisers

2.2 Economic Performance for the First Six Months of the Year

2.2.1 The UK economy cannot be considered in isolation and the impact of the financial and economic performance of other countries and groups of countries has a significant influence on the global economic position as well as that of the UK. This section of the report therefore sets out key issues relating the UK and other regions.

The UK Economic and Financial Position

2.2.2 After strong UK Gross Domestic Product (GDP) quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in quarter 1, 0.9% in quarter 2 and a first estimate of 0.7% in quarter 3 2014 (annual rate 3.1% in Q3), it appears very likely that strong growth will continue into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, 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 through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) in August 2013, before it said it would consider any increases in Bank Rate.

2.2.3 The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back 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 been at continuously low levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates 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.

2.2.4 Also encouraging has been the sharp fall in inflation as measured by the Consumer Price Index (CPI), reaching 1.2% in September, the lowest rate since 2009. Overall, markets are expecting that the MPC will be cautious in raising the Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in quarter 2 2015 and increases after that are expected to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.2.5 The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures disappointed in 2014/15.

The Economic and Financial Position of the U.S.A.

2.2.6 Through to September 2014 the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2013. Asset purchases having fallen from $85bn to $15bn stopped on 29th October 2014. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in quarter 2 to 4.6% (annualised).

The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions.

The Economic and Financial Position of the Eurozone (EZ)

2.2.7 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, 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 European Central Bank took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

2.2.8 Although concern in financial markets for the Eurozone subsided considerably during 2013, sovereign debt difficulties have not gone away. 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 Economic and Financial Position of China and Japan

2.2.9 Japan is causing considerable concern as the increase in sales tax in April has suppressed consumer expenditure and growth. In quarter 2 growth was -1.8% quarter on quarter and -7.1% over the previous year. The Government is hoping that this is a temporary blip.

2.2.10 As for 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 raised fresh concerns.

2.3 **Interest Rate Forecast**

2.3.1 The Council's treasury advisor, Capita Asset Services, has provided the following bank rate and Public Works Loan Board (PWLB) interest rate forecast covering the period from the last quarter of 2014 to the first quarter of 2018:

Interest Rate Forecasts for the period ending 31/12/14 to 31/3/18

	Dec-14	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	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
5yr PWLB rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

2.3.2 Capita Asset Services undertook a review of its interest rate forecasts (October 2014) resulting in the forecasts set out above. This was influenced by events during September and October, where there was a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, plus fears around Ebola and an accumulation of low growth news in most of the ten largest economies of the world and also on the growing risk of deflation in the Eurozone. As a result there had been a flight from equities into safe havens like gilts and depressed PWLB rates. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2015.

2.3.3 Current PWLB forecasts are based around a balance of risks. However, there are potential upside risks, especially for longer term PWLB rates, as follows: -

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds and into equities.
- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Downside risks currently include:

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.
- Fears generated by the potential impact of Ebola around the world
- UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade into 2015.
- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth into 2015.
- Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.

- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.
- Recapitalisation of European banks requiring more government financial support.
- Lack of support in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- Although the political situation in Italy has improved, it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- After being elected on an anti-austerity platform, the French President has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competiveness are also urgently required to lift the economy out of stagnation.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.
- There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge Quantitative Easing (QE) measures which remain in place (and may be added to by the European Central Bank (ECB) in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

2.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.4.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Oldham Council on 5th March 2014. The underlying TMSS approved previously now requires revision in the light of economic and operational movements during the year.

2.4.2 A decrease to both the overall Authorised Limit (the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003 above which the

Council does not have the power to borrow) and Operational Boundary (the expected borrowing position of the Council during the year) for external debt is required. This indicator is made up of external borrowing and other long term liabilities Private Finance Initiatives (PFI) and Finance Leases. The revision to the limits aligns to the reduction in the Capital Financing Requirement (£35.085m) as outlined at paragraph 2.4.4 below.

2.4.3 The Council has the following Private Finance Initiative (PFI) and Public Private Partnership (PPP) Schemes each contributing to the Other Long Term Liabilities element of the Authorised Limit and the Operational Boundary: :

- Gallery Oldham and Library
- Sheltered Housing (PFI2)
- Radclyffe and Failsworth Secondary Schools
- Chadderton Health & Well Being Centre
- Street Lighting
- Housing (PFI4)
- Blessed John Henry Newman RC College (BSF)

2.4.4 In addition, it will be necessary to decrease the Capital Financing Requirement (CFR) by £35.085m being £34.556m of slippage and other adjustments in the 13/14 capital programme reflected in the opening balance and expected slippage in the current year.

2.4.5 Members are therefore requested to approve the key changes to the 2014/15 prudential indicators as set out in the table below which show the original and recommended figures:

Prudential Indicator 2014/15	Original £'000	Recommended £'000
Authorised Limit	640,000	605,000
Operational Boundary	610,000	575,000
Capital Financing Requirement	597,618	562,533

2.5 **The Council's Capital Position (Prudential Indicators)**

2.5.1 This section of the report presents the Council's capital expenditure plans and their financing, the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow together with compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

2.5.2 The table below shows the half year position and forecast estimate for capital expenditure (Table 3 per the month 6 Capital Investment Programme monitoring report approved at Cabinet on 17th November 2014). It therefore highlights the changes that have taken place and are forecast since the capital programme was agreed at the Council meeting on 5th March 2014.

Capital Expenditure by Service	2014/15 Original Estimate £'000	2014/15 Forecast Estimate £'000
Commercial Services	15,637	33,731
Deputy Chief Exec / Corporate	0	0
Neighbourhoods	11,085	19,937
Commissioning	1,171	990
Development and Infrastructure	71,048	48,567
Yet To Be Allocated	12,232	3,779
Savings Allocated		3,834
General Fund Services	**111,173**	**110,838**
HRA	2,353	6,189
Total	**113,526**	**117,027**

2.5.3 The above table shows an increase in the capital programme, to the month 6 position of £3.501m. The original estimate was initially increased by slippage of £34.555m brought forward into the 2014-15 programme from the previous year; this has been offset by slippage into 2015/16, deletions and other movements showing a net decrease in the programme of £31.054m in the first 6 months of the year.

2.5.4 The movement between the 2014-15 original and forecast estimates is summarised in the table below

Capital Expenditure by Service	2014/15 Original Estimate £'000	2013/14 Slippage Brought Forward £'000	2014/15 Movement Periods 1 to 6 £'000	2014/15 Forecast Estimate £'000
Commercial Services	15,637	14,445	3,649	33,731
Deputy Chief Exec / Corporate	0	0	0	0
Neighbourhoods	11,085	7,709	1,143	19,937
Commissioning	1,171	29	-210	990
Development and Infrastructure	71,048	9,163	-31,644	48,567
Yet To Be Allocated	12,232		-8,453	3,779
Savings Allocated	0	0	3,834	3,834
General Fund Services	**111,173**	**31,346**	**-31,681**	**110,838**
HRA	2,353	3,210	626	6,189
Total	**113,526**	**34,556**	**-31,055**	**117,027**

Changes to the Financing of the Capital Programme

2.5.5 The table below draws together the main strategy elements of the capital expenditure plans (above) and the expected financing arrangements of this capital expenditure. The borrowing element of the table decreases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2014/15 Original Estimate £'000	2014/15 Forecast Estimate £'000
General Fund Services	111,173	110,838
HRA	2,353	6,189
Total spend	**113,526**	**117,027**
Financed by:		
Capital receipts	(10,953)	(14,588)
Capital grants	(18,229)	(32,740)
Revenue	(2,353)	(6,699)
Total financing	(31,535)	(54,027)
Borrowing need	**81,991**	**63,000**

Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

2.5.6 The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. As previously mentioned in paragraph 2.4.4 the CFR needs to decrease by £35.085m. It also shows the expected debt position over the period (the Operational Boundary). This indicator has decreased to reflect the revisions to the forecast year end position of the capital programme.

	2014/15 Original Estimate £'000	2014/15 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	597,618	562,533
Total CFR	**597,618**	**562,533**
Net movement in CFR		**(35,085)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	335,000	300,000
Other long term liabilities*	275,000	275,000
Operational Boundary	**610,000**	**575,000**

* - On balance sheet PFI schemes and finance leases etc. as previously explained.

Limits to Borrowing Activity

2.5.7 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose.

2.5.8 Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

2.5.9 The CFR calculation is shown in the table below and it is not anticipated that there will be any difficulties for the current or future years in complying with this prudential indicator:

Council Borrowing	2014/15 Original Estimate £'000	2014/15 Revised Estimate £'000
Gross borrowing (external debt)	240,830	147,824
Plus other long term liabilities*	271,459	270,736
Gross borrowing including Long Term Liabilities	512,289	418,560
CFR* (year-end position)	597,618	562,533

* - Includes on balance sheet PFI schemes and finance leases etc.

2.5.10 A further prudential indicator, the Authorised Limit, controls the overall level of borrowing, and needs to be set and revised by Members. It reflects the level of borrowing which, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. As previously outlined in the table in paragraph 2.4.5, it is recommended that this indicator is amended to reflect a decreased requirement

Authorised limit for external debt	2014/15 Original Indicator	2013/14 Revised Indicator
Borrowing	355,000	320,000
Other long term liabilities*	285,000	285,000
Total	**640,000**	**605,000**

* - Includes on balance sheet PFI schemes and finance leases etc.

Investment Portfolio 2014/15

2.5.11 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2.3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. Indeed, the introduction of the Funding for Lending scheme (a Bank of England and HM Treasury initiative designed to incentivise banks and building societies to boost their lending to the UK 'real' economy) has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

2.5.12 The Council held £111.445m of investments as at 30 September 2014 (£90.75m at 31 March 2014). A full list of investments as at 30 September 2014 is included in the table below. The Council keeps a large part of these funds on call (£71.5m at 30 September), adopting a prudent approach, because in the current financial climate it is sensible to retain flexibility to allow funds to be moved at immediate or short notice. Over half of the remaining investments are placed with other Local Authorities.

Investments	30th September 2014 £'000	Date of Investment	Date of Maturity
Bank of Scotland Fixed	5,000	09-May-14	10-Nov-14
Eastleigh BC	2,000	30-Apr-14	09-Jan-15
Cornwall CC	5,000	30-Apr-14	30-Jan-15
Bank of Scotland Fixed	3,000	09-May-14	09-Feb-15
Derby City Council	5,000	17-Feb-14	16-Feb-15
Nationwide BS	5,000	14-Aug-14	16-Feb-15
Birmingham City	5,000	29-Aug-14	03-Mar-15
Barclays Fixed	5,000	23-Sep-14	23-Mar-15
Greater London Authority	5,000	15-Apr-14	15-Oct-15
*Barclays Instant Access	9,595	30-Sep-14	01-Oct-14
*BOS Corporate Ac	10,600	23-Sep-14	01-Oct-14
*Ignis MMF	19,820	10-Sep-14	01-Oct-14
*Prime Rate MM Fund	19,980	01-Sep-14	01-Oct-14
*Goldman Sachs MMF	11,450	30-Sep-14	01-Oct-14
Total	**111,445**		

*- denotes instant access/ on call investments

2.5.13 The Council's investment strategy looks to achieve a return on its investment of London Interbank Bid Rate (LIBID) plus a 5% mark up. The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments up to 2 years if the cash flow forecast allows and the credit rating criteria is met. Performance against this benchmark was as follows:

Average 7 Day LIBID	0.35000%
Benchmark	0.36750%
Average 3 month LIBID	0.42000%
Benchmark	0.44100%
Average Return	0.46095%

2.5.14 The Council's performance exceeded its target by 0.09345% on 7 day LIBID and 0.01995% on 3 month LIBID.

Investment Counterparty Criteria

2.5.15 The Council currently has investment criteria and limits and these are set out in the table below. This shows the colour banding into which each of the counterparties are categorised, depending on their credit rating, and for each colour banding, the maximum duration of the investment and the maximum principal that can be invested.

Capital Colour Band	Maximum Duration	Maximum Principal Invested £
Yellow (Note 1)	3 Years	£10m
Purple	2 Years	£20m
Blue (Note 2)	1 Year	£20m
Orange (Note 3)	1 Year	£15m
Red	6 months	£10m
Green	100 days	£5m
No Colour	Not to be used	Not to be used

Note 1- Includes Public Sector Bodies
Note 2 - Blue Institutions only applies to nationalised or semi nationalised UK Banks, which are currently:

- Lloyds Banking Group – Lloyds and Bank of Scotland.
- RBS Group – Royal Bank of Scotland, Natwest Bank and Ulster Bank.

Note 3 - Includes the Council's banking provider, if it currently falls into another category.

2.5.16 The Council uses Capita Asset Services as its Treasury Advisors and uses its rating assessments to support investment decisions. Capita is changing its credit rating methodology and this impacts on the Councils own assessment methodology. This change is outlined in the following paragraphs.

2.5.17 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 they may remove these "uplifts". This process may commence during this financial year. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology upon which the Council places reliance are required and this is recommended for approval.

2.5.18It 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 support that has been built into ratings through the financial crisis. The eventual removal of implied Government 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.

2.5.19Fitch 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 monitoring both Long Term and these "standalone" ratings.

2.5.20Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "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.

2.5.21 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 Outlook information will continue to be assessed where it relates to these categories. Whilst this does not change the way in which Standard & Poor's information is presented, it is a change to the use of Fitch and Moody's ratings. Capita will continue to utilise Credit Default Swap prices as an overlay to ratings.

2.6 Borrowing

PWLB

2.6.1 The Council's CFR for 2014/15 is £562.533m and this denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

2.6.2 The table within paragraph 2.5.9 shows the Council has borrowings of £418.560m and has utilised £143.973m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

2.6.3 The Council has not undertaken any borrowing in the first half of the year, and did not undertake any debt rescheduling during the first half of 2014/15.

2.6.4 As outlined below, the general trend has been a decrease in interest rates during the six months, across longer dated maturity bands, but a rise in the shorter maturities, reflecting in part the expected rise in the Bank rate

2.6.5 Current PWLB maturity rates are set out in the following table and show for a selection of maturity periods over the first half of 2014/15, the range (high and low points) in rates and the average rates over the period. In addition, appendix 1 tracks the movement in the PWLB certainty rate over the period in question across the same range of loan terms as is used in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.20%	2.48%	3.16%	3.74%	3.72%
Date	08/04/2014	28/08/2014	28/08/2014	01/09/2014	29/08/2014
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.35%	2.66%	3.47%	4.10%	4.07%

2.6.6 The Council will closely monitor the movement in PWLB interest rates during the remaining months of the year. This will be considered in conjunction with the spend profile of the capital programme and borrowing may be undertaken to support the capital plans of the Council if this is considered advantageous.

2.6.7 H M Treasury has confirmed that the Council continues to be able to take advantage of the PWLB certainty rate for the period 1st November 2014 to 31st October 2015, whereby there is a 20 basis points discount on standard loans from the PWLB under the prudential borrowing regime for Authorities providing improved information on their long term borrowing and associated capital spending plans. The obvious benefit to the Council of the certainty rate will be reflected in the future with reduced Treasury Management borrowing costs in relation to any PWLB borrowing undertaken. The certainty rate variations are shown in Appendix 1.

Municipal Bonds Agency (MBA)

2.6.8 The Local Government Association (LGA) is currently working towards establishing a new Municipal Bonds Agency (MBA) the aim of which is to seek to provide Councils with a cheaper source of long term borrowing and to introduce sector owned diversity into the Local Government lending market. Following approval at Cabinet on 29th September 2014 the Council has agreed to invest a total sum of £100k in the first phase equity release of the MBA which will be used to fund the initial set up costs of the Agency. Phase 2, is intended to fund the launch phase of the Company through to operations and breakeven.

2.6.9 The Council has undertaken this investment to access a potentially cheaper source of long term borrowing. Assuming the Agency is successful in commencing operations, the Council will keep under review the availability and cost of funds from the MBA as an alternative source of finance with a view to borrowing at the appropriate time if terms are preferential. As an investor, the Council would expect to benefit from any profits generated by the MBA

2.7 Overall Position at the Mid –Year 2014/15

2.7.1 The position at the midyear 2014/15 shows that the Council is continuing to follow recommended practice and manage its treasury affairs in a prudent manner.

2.8 Current Position- Banking

2.8.1 As communicated in the 2013/14 Treasury Management Review, the Council now has a banking contract in place with Barclays Bank effective from 1st April 2014 for a duration of 5 years. At this early stage the working relationship between the parties is proving successful and it has enabled the Council to adopt a more traditional working relationship with its clearing bank.

2.9 Treasury Management Advisors

2.9.1 As advised earlier in the report, the Council uses Capita Asset Services as its Treasury Management advisors. The current contract expires on 31st March 2015 and the Council will be undertaking a tendering exercise to procure advisory services from April 2015. Discussions are taking place with other GM Local Government bodies with regard to a joint procurement exercise in order to provide financial savings for all. Progress in this exercise will be included in future reports.

3 **Options/Alternatives**

3.1 In order that the Council complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management the Council has no option other than to consider and note the contents of the report. Therefore no options/alternatives have been presented

4 **Preferred Option**

4.1 As stated above the preferred option is that the contents of the report are approved

5 **Consultation**

5.1 Consultation has taken place with Capita Asset Services the Councils Treasury Management Advisors, and the Executive Management Team (EMT). The report was approved by Cabinet on 15 December 2014 and is scheduled to be presented to the Audit Committee on 5 March 2015

6 **Financial Implications**

6.1 All included in the report.

7 **Legal Services Comments**

7.1 None

8 **Cooperative Agenda**

8.1 The Council ensures that any Treasury Management decisions comply as far as possible with the ethos of the Cooperative Council.

9 **Human Resources Comments**

9.1 None

10 **Risk Assessments**

10.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and policies are not adopted and followed. The Council has established good practice in relation to treasury management which have previously been acknowledged in the External Auditors' Annual Governance Report presented to the Audit Committee.

11 **IT Implications**

11.1 None

12 **Property Implications**

12.1 None

13 **Procurement Implications**

13.1 None

14 **Environmental and Health & Safety Implications**

14.1 None

15 **Equality, community cohesion and crime implications**

15.1 None

16 **Equality Impact Assessment Completed?**

16.1 No

17 **Key Decision**

17.1 Yes

18 **Forward Plan Reference**

18.1 CFHR -24-14

19 **Background Papers**

19.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref:	Treasury management investment and borrowing records and prudential indicators.
Name of File:	Treasury Management 2014/15 Half Year Review
Records held in:	Treasury & Capital Section Borough Treasurer's Department Level 14 Civic Centre West St Oldham
Officer Name:	Anne Ryans
Contact No:	0161 770 4902

20 **Appendices**

20.1 Appendix 1 – PWLB Certainty Rate Variations 2014-15

APPENDIX 1

PWLB Certainty Rate Variations 2014-15