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Council 25 February 2015

Treasury Management Strategy Statement 2015/16

Including Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

Portfolio Holder: Councillor Jabbar, Cabinet Member for Finance & HR

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Purpose of Report

To present to Council, the strategy for 2015/16 Treasury Management activities including the Minimum Revenue Position Policy Statement, the Annual Investment Strategy and Prudential Indicators.

Executive Summary

The report outlines the Treasury Management Strategy for 2015/16 including Prudential Indicators and the Minimum Revenue Provision policy.

The Strategy for 2015/16 covers two main areas.

Capital Issues

- The Capital plans and the Prudential Indicators
- The Minimum Revenue Provision Policy (MRP) Statement

Treasury Management Issues:

- The Current Treasury Position
- Treasury Indicators for the three years 2015/16 to 2017/18
- Prospects for Interest Rates
- The Borrowing Requirement
- The Borrowing Strategy
- Policy on Borrowing in Advance of Need
- Debt Rescheduling

- The Investment Strategy
- Creditworthiness Policy
- Policy on use of external service providers.

The report therefore outlines the implications and key factors in relation to each of the above Capital and Treasury Management issues and makes recommendations with regard to the Treasury Management strategy for 2015/16.

Recommendations

Council is requested to approve the:

- Capital Financing Requirement (CFR) Projections as per paragraph 2.2.3
- Minimum Revenue Provision policy and method of calculation as per section 2.3;
- Projected treasury position as at 31/03/2015 as per paragraph 2.5.3.
- Treasury Limits for 2015/16 to 2017/18 as detailed in sections 2.6.2 and 2.6.3;
- Borrowing Strategy for 2015/16 as per section 2.9
- Limits to interest rate exposures as set out in section 2.10.2;
- Upper and lower limits on fixed rate debt maturity structure as set out in Section 2.10.3
- Annual Investment Strategy as per section 2.14 including the investment credit rating criteria and the level of investment in non-specified investments;

Council **25th February 2015**

Treasury Management Strategy Statement 2015/16 Including Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

1 Background

1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low investment risk appetite, providing adequate liquidity initially before considering 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 that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 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. "

Statutory Requirements

1.4 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

CIPFA Requirements

1.5 The Council has adopted the Revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management 2011. The primary requirements of the code are as follows:

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

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives
- 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
- 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 section 151 Officer (Director of Finance). The treasury management role of the Section 151 Officer is shown at appendix 5
- Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee. The treasury management scheme of delegation is provided at Appendix 4.

Treasury Management Strategy 2015/16

1.6 The Strategy for 2015/16 covers two main areas.

1.6.1 Capital Issues

- The Capital plans and the Prudential Indicators
- The Minimum Revenue Provision (MRP) Policy Statement

1.6.2 Treasury Management Issues

- The Current Treasury Position
- Treasury Indicators for the three years 2015/16 to 2017/18
- Prospects for Interest Rates
- The Borrowing Requirement
- The Borrowing Strategy
- Policy on Borrowing in Advance of Need
- Debt Rescheduling
- The Investment Strategy
- Creditworthiness Policy
- Policy on use of external service providers.

These elements are each addressed with the Treasury Management report.

Balanced Budget Requirement

1.7 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a Local Authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure; and
- any increases in running costs from new capital projects;

are limited to a level which is affordable and within the projected income of the Council for the foreseeable future.

Treasury Management Consultants

1.8 Oldham Council uses Capita Asset Services, Treasury Solutions 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 external service providers.

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

1.10 The contract for external treasury management advisory services is due to expire on 31st March 2015; the Council has drawn up a contract specification and is intending to pursue a joint tender exercise with Bury Council, Warrington Council and the Greater Manchester Waste Disposal Authority. The intention being to have an AGMA wide agreement for the provision of advisory services that other Councils can adopt if they so desire as their respective contracts fall due for renewal.

2 Capital Plans & Prudential Indicators 2015/16 – 2017/18

2.1 Capital Plans

2.1.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist Member's overview and confirm capital expenditure plans. These indicators as per the Capital Programme include previous year's actual expenditure, forecast expenditure for this current year and estimates for the next three year period.

Capital Expenditure Estimates

2.1.2 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts in the table below:

Table 1 - Capital Expenditure Estimates

Capital Expenditure	2013/14 Actual £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Neighbourhoods	9,820	16,564	7,812	3,051	2,380
Commissioning	992	1,265	1,950	400	400
Commercial Services	13,680	24,545	19,058	10,466	17,840
Deputy Chief Executives/Corporate	0	100	0	0	0
Development and Infrastructure	15,828	37,601	61,824	37,272	8,685
Available for new projects	0	3,532	0	0	0
General Fund Services	**40,320**	**83,607**	**90,644**	**51,189**	**29,305**
HRA	3,344	6,189			0
HRA	**3,344**	**6,189**	**0**	**0**	**0**
Total	**43,664**	**89,796**	**90,644**	**51,189**	**29,305**

2.1.3 The capital expenditure shown above excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. It should be noted that new expenditure commitments are likely to increase the borrowing requirement

2.1.4 Table 2 below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing). The borrowing need for 2015/16 is £55.464m. This will however change if there is a change to the spending profile of the capital programme. Some of the expected borrowing will be supported by new income streams and is underwriting expected grants and contributions and may not be required.

Table 2 - Funding of the Capital Programme

Capital Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual £'000	Estimate £'000	Estimate £'000	Estimate £'000	Estimate £'000
General Fund Services	40,320	83,607	90,644	51,189	29,305
HRA	3,344	6,189	0	0	0
Total	43,665	89,796	90,644	51,189	29,305
Financed by:					
Capital receipts	(4,098)	(10,780)	(14,554)	(3,723)	(1,280)
Capital grants	(15,872)	(26,090)	(20,026)	(14,589)	(19,340)
Revenue	(7,842)	(17,405)	(600)	0	0
Net financing need for the year	**15,852**	**35,521**	**55,464**	**32,877**	**8,685**

2.1.5 All other performance indicators included within this report are based on the above capital estimates.

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

2.2.1 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.

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

2.2.3 The CFR includes other long term liabilities (e.g. Private Finance Initiative (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 £271m of such schemes within the CFR, decreasing to £266m in 2015/16.

Table 3 Capital Financing Requirement (CFR)

	2013/14 Actual £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Capital Financing Requirement					
CFR	479,699	534,730	572,382	582,022	567,767
CFR - housing					
Total CFR	**479,699**	**534,730**	**572,382**	**582,022**	**567,767**
Movement in CFR	**13,297**	**55,031**	**37,651**	**9,640**	**(14,255)**
Movement in CFR represented by					
Net financing need for the year (above)	15,852	35,521	55,464	32,877	8,685
PFI Additions	19,713	38,840	3,737	0	0
Less MRP/VRP and other financing movements	(22,268)	(19,329)	(21,550)	(23,237)	(22,940)
Movement in CFR	13,297	55,031	37,651	9,640	(14,255)

2.3 Minimum revenue provision (MRP) policy statement

2.3.1 The Council is required to pay off an element of the accumulated capital spend each year (the CFR) through a revenue charge, the minimum revenue provision, to

the income and expenditure account. The Council is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

2.3.2 Department for Communities and Local Government (CLG) regulations require the full **MRP Statement** in advance of each year to be decided upon and reported to Council. The Council has to ensure that the chosen options are prudent.

2.3.3 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will follow existing practice outlined in former CLG regulations. This sets aside 4% each year of the Council's Capital Financing Requirement less an adjustment for changes to regulations. This historic approach will continue for all capital expenditure incurred in the years before the change was introduced.

2.3.4 From 1 April 2008 for all unsupported borrowing, referred to as prudential borrowing the MRP policy will be the Asset Life Method. MRP will be based on the estimated life of the assets, in accordance with the regulations issued by CLG. The calculation of the provision will either be the annuity method or equal instalments method depending on which is most appropriate. Furthermore, where appropriate provision for MRP will commence upon the completion of assets rather than when expenditure is incurred.

2.3.5 Repayments included in annual PFI or finance leases are applied as MRP.

2.3.6 The Council currently operates a Local Authority Mortgage Scheme (LAMS) using the cash backed option. The mortgage lenders require a five year deposit from the Local Authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the Local Authority, the returned funds are classed as a capital receipt, which will be applied to reduce the CFR. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

2.4 Affordability prudential indicators

2.4.1 The previous sections cover the overall capital programme and control of borrowing prudential indicators, but within this framework, prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. Council is asked to approve the following indicators:

a) 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 this report.

Table 4 Ratio of net financing cost to net revenue stream

	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
General Fund excluding DSG	14.10%	14.95%	18.62%	22.03%	23.52%

Table 4 above includes financing costs in relation to PFI schemes, for which the Council receives PFI grant direct from Central Government and therefore the above figures would reduce with the exclusion of PFI income and expenditure i.e. the Councils financing costs requiring funding from the council tax base.

b) Incremental impact of new capital investment decisions on council tax

Table 5 identifies the revenue costs associated with proposed changes to the capital programme recommended in the report for 2015/16 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 five year period. The indicators in tables 4 and 5 will change with any variation in the profile of expenditure.

Table 5 Incremental impact of new capital investment decisions on band D council tax

	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Increase in council tax (Band D)	£14.45	£26.98	£57.44	£86.10	£50.56

2.4.2 The above calculation is based on Band D equivalent properties, using the proposed tax base for 2015/16 of 53,401 properties.

2.5 Borrowing

2.5.1 The capital expenditure plans set out in section 2.1 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 and prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

2.5.2 The Council's treasury portfolio position at 31 March 2015, with forward projections is summarised below. Table 6 shows the actual external debt (the treasury

management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

2.5.3 Table 6 shows the forecast position of gross borrowing as at 31st March 2015 at £443,853k and an under borrowed position of £90,877k. Council is asked to note the expected year end position.

Table 6 Current & Forecast Treasury Portfolio

	2013/14 Actual £'000	Forecast position as at 31/3/15 £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
External Debt					
Debt @ 1st April	148,425	148,117	173,117	216,117	234,617
Expected change in debt	(309)	25,000	43,000	18,500	0
Other long-term liabilities	240,600	248,003	270,736	266,141	258,022
Expected change in OLTL*	7,403	22,733	(4,595)	(8,118)	(6,849)
Actual gross debt at 31 March	**396,120**	**443,853**	**482,257**	**492,639**	**485,790**
The Capital Financing Requirement	**479,699**	**534,730**	**572,382**	**582,022**	**567,767**
Under / (over) borrowing	**83,579**	**90,877**	**90,125**	**89,383**	**81,977**

* Other Long Term Liabilities (OLTL)

2.5.4 Table 6 above shows the Council will need to take out significant borrowings during 2015/16 to 2017/18 if the capital programme spends in accordance with the anticipated profile. The borrowing requirement is a key influence over the borrowing strategy as set out in section 2.9. However, the Council has not yet needed to take out additional borrowing and the timing of the borrowing is being closely monitored

2.5.5 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 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. It is clear from the table above that the Council's gross borrowing position is well within these limits.

2.5.6 The Council has complied with this prudential indicator in the current year and does not envisage difficulties in the future. This view takes into account current commitments, existing plans, and the proposals in this report.

2.6 Treasury Limits for 2015/16 to 2017/18

2.6.1 The Council is required to determine its operational boundary and authorised limit for external debt for the next three years.

Operational boundary

2.6.2 The proposed operational boundary for 2015/16 to 2017/18 is set out in Table 7 below. The boundary reflects the maximum anticipated level of external debt consistent with budgets and forecast cash flows, and the capital financing requirement. This boundary will be used as a management tool for ongoing monitoring of external debt, and may be breached temporarily due to unusual cash flow movements. However a sustained or regular trend above the operational boundary should trigger a review of both the operational boundary and the authorised limit.

Table 7 Operational Boundary

Operational boundary	2014/15 Forecast £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Borrowing	280,000	325,000	345,000	335,000
Other long term liabilities	280,000	275,000	270,000	260,000
Total	**560,000**	**600,000**	**615,000**	**595,000**

Authorised limit

2.6.3 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.

Council is asked to note the following authorised limit:

Table 8 Authorised Limit

Authorised limit	2014/15 Forecast £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Borrowing	300,000	345,000	365,000	355,000
Other long term liabilities	290,000	285,000	280,000	270,000
Total	**590,000**	**630,000**	**645,000**	**625,000**

2.7 Prospects for Interest Rates

2.7.1 The Council has appointed Capita Asset Services as its Treasury Advisor and part of it's service is to assist the Council to formulate a view on interest rates. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita Asset Services view to March 2018.

Table 9 Interest Rate Forecast

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.10	3.30	3.30
Jun 2015	0.50	2.20	3.40	3.40
Sep 2015	0.50	2.30	3.60	3.60
Dec 2015	0.50	2.50	3.80	3.80
Mar 2016	0.75	2.60	3.90	3.90
Jun 2016	0.75	2.70	4.00	4.00
Sep 2016	1.00	2.80	4.20	4.20
Dec 2016	1.25	3.00	4.30	4.30
Mar 2017	1.25	3.10	4.40	4.40
Jun 2017	1.50	3.20	4.50	4.50
Sep 2017	1.50	3.30	4.60	4.60
Dec 2017	1.75	3.40	4.60	4.60
Mar 2018	2.00	3.50	4.70	4.70

2.7.2 UK Gross Domestic Product (GDP) growth surged during 2013 and 2014 but cooled somewhat towards the end of 2014. However, growth is expected to regain stronger momentum during 2015 and 2016 under the stimulative effect of the sharp fall in oil prices and inflation potentially falling into negative territory, but anyway being near to zero until towards the end of 2015. Combined with a significant rise in average wage rates, this is expected to lead to consumer disposable income rising by around 3.5% in 2015. This would therefore strengthen consumer expenditure without much downside to the savings ratio.

2.7.3 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.

2.7.4 The Bank of England February Inflation Report drew attention to the falling level of unemployment and the reduction of spare capacity or slack in the economy. This is expected to feed through into an increase in pressure for wage increases and together with the sharp fall in the price of oil starting to fall out of the twelve month calculation of Consumer Price Inflation (CPI) in quarter 4 of 2015, is expected to result in a sharp rise in inflation from near zero in that quarter and also onward into 2016.

2.7.5 The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in quarter 2 2014 and 5.0% in quarter 3, followed by a cooler 2.6% in quarter 4 (overall 2.4% for 2014 as a whole). 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.

2.7.6 Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by the end of 2015.

2.7.7 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 brought to power a coalition which is strongly anti EU imposed austerity. However, if this should eventually result 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 gauge;

- 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 and the Middle East, 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 and early 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The opening weeks of 2015 saw gilt yields dip to historically phenominally low levels after inflation plunged, a flight to quality as a result of the Greek situation and the start of a huge programme of quantitative easing (purchase of EZ government debt), by the ECB in January 2015.

- The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

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

2.8 Public Works Loan Board (PWLB) rates

2.8.1 PWLB rates are expected to gradually increase during the year and continue to do so for the next three years. Rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt. There is likely to be little or no difference between 25 year and 50 year rates thus loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less.

2.9 Borrowing strategy

2.9.1 The factors that influence the 2015/16 strategy are: -

- The increasing Capital Financing Requirement as per Table 3

- Impending Option dates on £59m of Lender Option Borrower Option loans (LOBO's) in 2015/16

- The interest rate forecasts (as included in Table 9)

- Aiming to minimise revenue costs to minimise the impact on Council Tax.

- The impact of the Council's Investment Programme

2.9.2 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high, however as interest rates are low, consideration will be given to taking advantage of this by securing fixed rate funding and reducing the under borrowed position.

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

- if it was considered 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 considered 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 greater than expected increase in the anticipated rate to US tapering of asset purchases, or 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.

2.9.4 The gross borrowing requirement in Table 6 shows, based on current estimates, that the Council will need to take out a significant amount of new borrowings, to support the capital programme. Any new borrowing taken out will be completed with regard to the limits, indicators and interest rate forecasts set out above.

2.9.5 During 2015/16, £59m of LOBO (Lender Option Borrower Option) debt will reach the option renewal date. Table 10 sets out the maturity structure of fixed rate debt. At the renewal date the loans will either:

- Move to the option rate of interest, which in all cases will be the same as the current rate or:

- Be offered at a rate above the option rate, in which case the Council has the option to repay. This would then require re-financing at the prevailing market rates. Based on current interest rates it is not anticipated that these loans will require re-financing.

2.9.6 The latest 2014/15 capital programme now shows anticipated prudential borrowing of £35.521m with £55.464m in 2015/16 and £32.877m in 2016/17. These figures have been reflected in this report and factored into the borrowing strategy for 2015/16 and future years. As highlighted earlier some of this is to be financed by external income streams.

2.10 Treasury Management Prudential Indicators – Limits on Activity

2.10.1 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 and, or improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

2.10.2 Council is asked to approve the limits on interest rate exposures:

Table 10 - Limits on Interest rate exposures

	2015/16 £'000	2016/17 £'000	2017/18 £'000
Upper Limit on Fixed Interest Rate Exposure	100%	100%	100%
Upper Limit on Variable Interest Rate Exposure	30%	30%	30%

2.10.3 Table 11 below sets out the proposed upper and lower limits on maturity structure of fixed rate debt, for 2015/16. The maturity structure guidance of LOBO's (Lender Option Borrower Option) changed in the 2011 guidance notes, the call date is now deemed to be the maturity date. LOBO's are classed as fixed rate debt until the call date. Within the next 12 months 2015/16 up to 47% of LOBO debt will reach its call date, however it is not anticipated that these loans will be called by the lending institutions and require refinancing.

Table 11 Upper and lower limits on maturity structure of fixed rate debt

Maturity Structure of fixed interest rate debt	2015/16 Upper Limit	2015/16 Lower Limit
Under 12 months	40%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	5%	0%
10 years and above	100%	40%

2.11 Policy on Borrowing in Advance of Need

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

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

2.12 Debt Rescheduling

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

2.12.2 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;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

2.12.3 Consideration will also be given to identifying 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.

2.12.4 All rescheduling will be reported to Cabinet and Council at the earliest meeting following its action.

2.13 Local Capital Finance Company (originally Municipal Bond Agency)

2.13.1 It is likely that Local Capital Finance Company, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB).

2.13.2 The Council has currently invested £100k in the Company and intends to make use of this new source of borrowing as and when appropriate.

2.14 Annual investment strategy

Changes to credit rating methodology

2.14.1 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 2014/15 and, or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

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

2.14.3 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in

line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

2.14.4 Furthermore, 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.

2.14.5 As a result of these rating agency changes, the credit element of our 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. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise Credit Default Swap (CDS) prices as an overlay to ratings in our new methodology.

Investment Policy

2.14.6 The Council's investment policy has regard to the Department for Communities and Local Government (CLG's) Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:

- firstly, the security of capital
- secondly, the liquidity of it's investments
- thirdly, the optimum return on its investments comensurate with proper levels of security and liquidity
- finally, ethical Investments.

2.14.7 In accordance with the above guidance from the CLG 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 avoids risk concentration.

2.14.8 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.

2.14.9 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.

2.14.10 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.

2.14.11 Investment instruments identified for use in the financial year are detailed below under the ‘specified’ and ‘non-specified’ investments categories.

Specified Investments

2.14.12 The table below sets out the specified investments. These are sterling denominated with maturities less than 364 days, meeting the minimum ‘high’ rating criteria where applicable.

Table 12 Specified Investments

Type of Investment	Minimum credit criteria / colour band	Max. maturity period
Debt Management Account Deposit Fund – UK Government (Debt Management Office)	N/A	6 months
UK Government gilts	UK sovereign rating	1 year
UK Government Treasury bills	UK sovereign rating	1 year
Money market funds	AAA	Liquid
Enhanced money market funds	AAA	Liquid
Public Sector Bodies	N/A	1 year
Term deposits with banks and building societies	Blue	1 year
	Orange	1 year
	Red	6 Months
	Green	100 days
	No Colour	Not for use
CDS or corporate bonds with banks and building societies	Blue	1 year
	Orange	1 year
	Red	6 Months
	Green	100 days
	No Colour	Not for use
Corporate bond funds	N/A	1 year

Gilt funds	UK sovereign rating	1 year
Property funds	N/A	1 year

Non Specified investments

2.14.13 The table below lists some of the non-specified investments. These are investments which do not meet the specified investment criteria detailed above in Table 12.

Table 13 Non specified investments

Type of Investment	Minimum credit criteria / colour band	Max. maturity period
UK Government gilts	UK sovereign rating	2 years
UK Government Treasury bills	UK sovereign rating	2 years
Public Sector Bodies	N/A	5 years
Term deposits with banks and building societies	Yellow	5 years
	Purple	2 years
	No Colour	Not for use
CDS or corporate bonds with banks and building societies	Yellow	5 years
	Purple	2 years
	No Colour	Not for use
Corporate bond funds	N/A	2 year
Gilt funds	UK sovereign rating	2 year
Municipal Bonds Agency	N/A	N/A
Property funds	N/A	3 Years

2.14.14 As highlighted above (2.3.6), the Council participates in the Local Authority Mortgage Scheme. Under this scheme the Council has placed funds of £2m, with Lloyds TSB, for a period of 5 years. This is classed as being a service investment rather than a treasury management investment, and is also outside the specified / non specified categories.

2.15 Creditworthiness policy

2.15.1 Oldham Council applies the creditworthiness service provided by Capita Asset Services Treasury Advisors. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poor. The credit ratings of counterparties are supplemented with the following overlays:

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

2.15.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments.

2.15.3 Institutions are split into colour bandings and the Council will therefore use counterparties within these colours, durational bands and investment limits. Table 14 below shows these limits.

Table 14 Investment Criteria

Capital Colour Band	Maximum Duration	Maximum Principal Invested £
Yellow (Note 1)	5 Years	£10m
Dark Pink (Note 2)	5 Years	£10m
Light Pink (Note 3)	5 Years	£10m
Purple	2 Years	£20m
Blue (Note 4)	1 Year	£20m
Orange (Note 5)	1 Year	£15m
Red	6 months	£10m
Green	100 days	£10m
No Colour	Not to be used	Not to be used

Note 1 – Includes Public Sector Bodies

Note 2 – Enhanced money market funds (EMMF) with a credit score of 1.25

Note 3 - Enhanced money market funds (EMMF) with a credit score of 1.5

Note 4 – 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 5 - Includes the Council's banking provider, if it currently falls into category below this colour band.

2.15.4 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.

2.15.5 Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

2.15.6 All credit ratings will be monitored on a daily basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Sevices Treasury Advisory creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn or notice given to withdraw immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

2.15.7 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on Government support for banks and the credit ratings of that supporting Government.

2.16 Country Limits

2.16.1 It is not proposed to restrict the Council's investment policy to only UK banks and building societies, however in addition to the credit rating criteria set out above consideration will be given to the sovereign rating of the country before any investment is made.

2.16.2 In February 2013 the UK lost its AAA rating and moved to an AA+ rating. The Council will continue to invest with UK Banks, providing the individual institutions still meet the relevant criteria

2.16.3 The Council has determined that it will only use approved counterparties from non UK countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy, therefore for illustrative purposes the appended list is extended to also show AA+ i.e. the countries currently assesed to be in the rating below those that currently qualify.

2.17 Investment Strategy

2.17.1 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). The Council currently has investments totalling £15m which span the financial year as shown in Table 15. These investments are either current as at February 2015 or forward deals that commence in the new financial year 2015/16.

Table 15 Investments maturing in 2015/16

Counterparty	Amount	Maturity Date	Rate
Leeds Building Society	£5,000,000	30/04/2015	0.50%
Bank of Scotland	£5,000,000	11/05/2015	0.70%
Bank of Scotland	£5,000,000	04/06/2015	0.70%
Grt London Authority (GLA)	£5,000,000	15/10/2015	0.90%

2.17.2 The Bank Rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 1 of 2016. Bank rates forecasts for financial year ends are:

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

2.17.3 There are downside risks to these forecasts (i.e. the 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.

2.17.4 The Council looks to achieve a return on its investment greater than the London Interbank Bid Rate (LIBID). It will benchmark investment returns both on 7 day LIBID and 3 month LIBID multiplied by 5%. Forecast LIBID rates can be seen in Appendix 1.

2.17.5 The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments for up to 5 years if the cash flow forecast allows and the credit rating criteria is met.

2.17.6 The Council will avoid locking into longer term deals i.e., "more than 364 days" while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the Council.

2.17.7 For daily cash management, the Council will seek to utilise its business reserve instant access accounts, 15 and 30 day accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

Investment Treasury Indicator and Limit

2.17.8 This indicator looks at total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of investment, and are based on the availability of funds after each year end.

Table 16 – Maximum principal sum invested greater than 364 days

	2015/16	2016/17	2017/18
Principal sums invested > 364 days	£20m	£20m	£20m

2.18 Investment Risk Benchmarking

2.18.1 These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft facility £2m
- Liquid short term deposits of at least £10m available with a week's notice.

Yield - local measures of yield benchmarks are

- Investments – internal returns above the 7 day LIBID rate multiplied by 5%
- Investments – internal returns above the 3 month LIBID rate multiplied by 5%

2.18.2 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report, which is in accordance with required practice and is presented to Council and Cabinet for approval.

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 approve the contents of the report. Therefore no options/alternatives have been presented. The role of Cabinet is to approve the proposed Treasury Management Strategy to ensure that the document that the Council is approving is robust and enables the financial position of the Council to be safeguarded.

4 Preferred Option

4.1 The preferred option is that the contents of the report are approved by Council

5 Consultation

5.1 There has been consultation with Capita Asset Services, Treasury Management Advisors, the Overview and Scrutiny Performance and Value for Money Select Committee at its meeting on 22nd January 2015. The report was approved by Cabinet on 16th February 2015.

6 Financial Implications

6.1 All included in the report.

7 Legal Services Comments

7.1 None

8 Cooperative Agenda

8.1 The treasury management strategy embraces the Council's cooperative agenda. The Council will develop its investment framework to ensure it complements the cooperative ethos of the 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 **Equality Impact Assessment Completed?**

17.1 No

18 **Key Decision**

18.1 Yes

19 **Forward Plan Reference**

19.1 CFHR -14 - 22

20 **Background Papers**

20.1 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:	Background papers are provided in Appendices 1 - 6
Officer Name:	Anne Ryans
Contact No:	0161 770 4902

21 **Appendices**

Appendix 1	Capita Asset Services - Treasury Advisor's Interest Rate Forecast 2015-18
Appendix 2	Economic Background
Appendix 3	Approved Countries for Investments
Appendix 4	Treasury Management Scheme of Delegation
Appendix 5	Treasury Management Role of the S151 Officer
Appendix 6	Treasury Management Indicators

Appendix 1 – Capita Asset Services Interest rate forecast 2015 – 2018

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

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%	0.50%	0.75%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.70%	0.80%	1.00%	1.10%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.00%	1.10%	1.30%	1.40%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.10%	2.20%	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB Rate	2.70%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB Rate	3.30%	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%
50yr PWLB Rate	3.30%	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	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	2.10%	2.20%	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
Capital Economics	1.80%	2.05%	2.30%	2.55%	2.80%	2.80%	3.05%	3.05%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.70%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%
Capital Economics	2.30%	2.55%	2.55%	2.80%	3.05%	3.05%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.30%	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%
Capital Economics	2.95%	3.15%	3.15%	3.50%	3.90%	3.90%	4.15%	4.15%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.30%	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%
Capital Economics	3.10%	3.30%	3.30%	3.60%	4.00%	4.00%	4.30%	4.30%	-	-	-	-	-

APPENDIX 2: Economic Background

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.

UK.

After strong UK Gross Domestic (GDP) growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in quarter 1, 0.8% quarter 2, 0.7% quarter 3 and 0.5% quarter 4 (annual rate for 2014 of 2.6%), growth is expected to gain increased momentum during 2015 and 2016 to annual rates of 2.9%, (2017 2.7%). This will be a response to two developments; firstly, the stimulative effect of the sharp fall in oil prices in quarter 4 of 2014 and then inflation potentially falling into negative territory during 2015, but anyway being near to zero until towards the end of the year. Secondly, due to an expected return to a significant rise in average wage rates due to the continuing fall in unemployment to about 5.5% by mid 2015, (the long run equilibrium level is 5.0%), and the further erosion of spare capacity, (slack), to about 0.5% of GDP. This is expected to lead to total consumer disposable income rising by no less than around 3.5% during quarter 3 2015. This would therefore strengthen consumer expenditure, but without much downside to the savings ratio.

However, for this recovery to become more balanced and sustainable in the longer term, the recovery still 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.

In addition, there has been a need for a major improvement in labour productivity, which has languished at dismal levels since 2008, to support longer term increases in pay rates and economic growth after the positive effect of the fall in oil prices dissipates. The February Inflation Report contained good news on that score that productivity was forecast to increase by just under 0.75% in the first three quarters of 2015.

The February Inflation Report also explained that the initial fall in the price of oil of over 50% would cause an overall reduction in CPI of about 0.8% in quarter 2 2015 and boost UK GDP by around 0.5% during the Monetary Policy Committees (MPC) three year forecast period.

It also forecast that the sharp fall in the price of oil and its knock on effects, would start falling out of the twelve month calculation of CPI inflation in quarter 4 of 2015. This is expected to result in a sharp rise in inflation from near zero in that quarter and also onward into 2016.

The report also mentioned a potential risk of deflation becoming embedded, which could then require remedial action by the MPC such as a cut in Bank Rate and / or further quantitative easing, This is viewed as being a small risk given the above expected sharp increase in inflationary pressures.

However, while inflation is at or near 0% for much of 2015, it is unlikely that the MPC would make a start on increasing Bank Rate. Market expectations for the first increase in

Bank Rate have therefore moved from quarter 3 2015 after the November 2014 report, to around mid year 2016 during February 2015.

However, the MPC is focused on where inflation will be over a 2 – 3 year time horizon so too much emphasis should not be placed on the short term inflation outlook, especially when the February report identified a slight increase in inflationary pressures on that time horizon to just above the 2% target.

This treasury management report is therefore based on a forecast of a first increase in Bank Rate in quarter 1 of 2016, though it would be quite possible for it to be in quarter 4 of 2015 if events were to turn out favourably in Greece, the EZ as a whole and elsewhere.

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, being only a fraction lower than the previous year through to December 2014.

The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated. The flight to quality in January 2015 has seen gilt yields fall to incredibly low levels, which will reduce interest costs on new and replacement government debt.

Eurozone (EZ).

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In January 2015, the inflation rate fell further, to reach a low of -0.6%. However, this is an average for all EZ countries and includes some countries with even higher negative rates of inflation.

Initially, the European Central Bank (ECB) took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. As this failed to have much of a discernible effect, the ECB launched a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme will run to September 2016.

Concern in financial markets for the Eurozone had 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 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 for 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 on 25 January 2015 has brought to power a coalition which is anti EU imposed austerity. Although it is not certain that Greece will leave the Euro, the recent intractability of the troika (the EU, ECB and the International Monetary Fund), to finding a negotiated compromise with the new Greek government leaves this as a real possibility. However, if Greece was to leave the EZ, 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. Nevertheless, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to gauge.

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. Of particular concern is the fact that Spain and Portugal have general elections coming up in late 2015. This will give ample opportunity for anti austerity parties to make a big impact.

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 quarter 2 of 4.6%, quarter 3 of 5.0% and quarter 4 of 2.6%, (overall 2.4% during 2014 as a whole), provides great promise for strong growth going forward. It is confidently forecast that the first increase in the Fed. rate will occur by the end of 2015.

China. Government action in 2014 to stimulate the economy almost succeeded in achieving the target of 7.5% growth but recent government statements have emphasised that growth going forward will slow marginally as this becomes the new normal for China.

There are concerns that the Chinese leadership has only just 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. The Japanese government already has the highest debt to GDP ratio in the world.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. 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.

There has been exceptionally high volatility in gilt yields and PWLB rates during January and February 2015. It is likely that this trend could continue through 2015 and that there could be swings of 50 basis points, (0.50%), during even one quarter.

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 PWLB rates, especially for longer term PWLB 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.
- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate in 2015, causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities. There could also be a sharp fundamental reassessment of investments in the debt and equities of emerging countries which have chased higher yields during a prolonged period when yields and returns in western countries have been heavily suppressed; countries such as Brazil and Russia are already in recession and facing major economic and political challenges.
- 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.

APPENDIX 3: Approved countries for investments

February 2015

AAA

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

AA+

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

APPENDIX 4: Treasury management scheme of delegation

The scheme of delegation is as follows:

(i) Full council is the responsible body for:

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;

(ii) Cabinet is the responsible body for:

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Audit Committee is responsible for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

APPENDIX 5: The treasury management role of the section 151 officer (Director of Finance)

The S151 (responsible) officer will discharge the treasury management role by:

- 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;
- recommending the appointment of external service providers.

Appendix 6 - TREASURY MANAGEMENT INDICATORS

Table 1 Prudential indicators	2013/14 actual £'000	2014/15 probable out-turn £'000	2015/16 estimate £'000	2016/17 estimate £'000	2017/18 estimate £'000
Capital Expenditure					
General Fund	40,320	83,607	90,644	51,189	29,305
HRA	3,344	6,189	0	0	0
TOTAL	**43,664**	**89,796**	**90,644**	**51,189**	**29,305**
In year Capital Financing Requirement (Including Long term Liabilities)					
General Fund	13,297	55,031	37,651	9,640	(14,255)
Capital Financing Requirement as at 31 March (Including Long Term Liabilities)					
General Fund	479,699	534,730	572,382	582,022	567,767
Borrowing requirement	0	25,000	43,000	18,500	0
Ratio of financing costs to net revenue stream					
General Fund	14.10%	14.95%	18.62%	22.03%	23.52%
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	14.45	26.98	57.44	86.10	50.56

TABLE 2: Treasury management indicators	2013/14 actual £'000	2014/15 probable out-turn £'000	2015/16 estimate £'000	2016/17 estimate £'000	2017/18 estimate £'000
Operational Boundary for external debt -					
borrowing		280,000	325,000	345,000	335,000
other long term liabilities		280,000	275,000	270,000	260,000
TOTAL	**0**	**560,000**	**600,000**	**615,000**	**595,000**
Authorised Limit for external debt -					
borrowing		300,000	345,000	365,000	355,000
other long term liabilities		290,000	285,000	280,000	270,000
TOTAL	**0**	**590,000**	**630,000**	**645,000**	**625,000**
Actual external debt	396,120				
Upper Limit on Fixed Interest Rate Exposure		100%	100%	100%	100%
Upper Limit on Variable Interest Rate Exposure		30%	30%	30%	30%
Upper limit for total principal sums invested for over 364 days		20,000	20,000	20,000	20,000

TABLE 3: Maturity structure of new fixed rate borrowing during 2015/16	Upper Limit	Lower Limit
under 12 months	40%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	5%	0%
10 years and above	100%	40%