

## **APPENDIX 1**

### **Treasury Management Strategy Statement 2017/18 And Prudential Indicators 2017/18 to 2019/20**

## TREASURY MANAGEMENT STRATEGY STATEMENT

### 1. Introduction

- 1.1. This Treasury Management Strategy statement (TMS) has been compiled in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice (the code) on Treasury Management (revised 2011).
- 1.2. The Council's TMS will be approved annually by the full Council along with the mid-year and outturn reports. From 2016/17 onwards the Audit Committee is the nominated body responsible for ensuring effective scrutiny of the treasury management strategy and policies and will receive reports as set out in the table, paragraph 1.5 below.
- 1.3. The Financial monitoring panel will also be presented with monthly monitoring reports detailing projected income forecasts, creditworthiness updates and operational changes to treasury activities.
- 1.4. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function understand fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.
- 1.5. As noted above this Council has adopted the following reporting arrangements in accordance with the requirements of the revised Code:

Report	Committee	Frequency
Treasury Management Strategy (TMS)	Audit Committee - Scrutiny	Annually before the start of the financial year
	Full Council - Approval	Annually before the start of the financial year
Treasury Management Mid-year review	Audit Committee - Scrutiny	Annually at next available Audit Committee following 30 September
	Full Council – To Note	Annually with TMS
Annual Treasury Outturn Review	Audit Committee - Scrutiny	Annually by the 30 September after each year end
	Full Council – To Note	Annually with TMS
Treasury Management Monitoring Reports	Financial Monitoring Panel	Quarterly

1.6. 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 such as: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs as a result of new capital projects.

It is important that these costs are limited to a level which is affordable and within the projected income of the Council for the foreseeable future.

1.7. The Act also requires the Council to set out its treasury strategy for investments and borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) which is included in section 7 of this report; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.8. This strategy includes views on interest rates and leading market forecasts provided by the Council's treasury advisor, Capita Asset Services.

## **2. Treasury Management Strategy for 2017/18**

2.1. The strategy for 2017/18 covers:

- **Training**
- **Policy on use of external Treasury advisors**
- **Prudential Indicators 2017/18 – 2019/20**

Capital Expenditure Plans  
Capital Financing Requirement (CFR)  
Minimum revenue provision (MRP) Policy Statement  
Investment Balances  
Capital affordability indicators  
Borrowing Requirements  
Borrowing – Current position, Operational Boundary, Authorised limit  
Treasury Limits  
Policy on borrowing in advance of need

- **Current portfolio position**

- **Annual Investment Strategy**

- Investment Policy
- Types of investments
- Prospects for interest rates
- Creditworthiness Policy
- Counterparty and Group limits
- Time and monetary limits
- Sovereign limits
- Money Market Funds
- Enhanced Money Market Funds
- Main Bankers
- Local Authority Mortgage Scheme (LAMS)

- **Alternative Approach**

- **Scheme of Delegation**

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

### **3. Training**

3.1. The CIPFA Code requires the Director of Resources as the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny and training will be provided as necessary.

### **4. Treasury management advisors**

4.1. The Council use Capita Asset Services as its external treasury management advisors. However the Council recognises that responsibility for treasury management decisions remain with the organisation at all times and will ensure that undue reliance is not placed upon our external advisors.

The Council also recognise the value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

## **5. The Capital Prudential Indicators 2017/18 – 2019/20**

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

### **5.2. Capital Expenditure**

5.2.1. 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 note the capital expenditure forecasts which match the forecast as set out in the Capital Budget 2017/18 (report ref C17-10)

**Table 1 Capital expenditure**

<b>£'000</b>	<b>2016/17 Original Budget</b>	<b>2016/17 Revised Budget</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>Total Budget</b>
Asset Management	2,309	1,080	1,874	995	0	<b>3,949</b>
Engineering Services	5	0	9	0	0	<b>9</b>
Planning & Building Control	29	0	109	0	0	<b>109</b>
Environmental Health	369	451	430	430	430	<b>1,741</b>
Partnerships & Community Support	36	0	66	0	0	<b>66</b>
Street Scene Services	701	128	1,392	0	0	<b>1,520</b>
Finance And Business Services	218	1	365	0	0	<b>366</b>
Human resources & Customer Services	6	0	21	0	0	<b>21</b>
Housing Services	0	0	0	0	0	<b>0</b>
<b>Total</b>	<b>3,673</b>	<b>1,660</b>	<b>4,266</b>	<b>1,425</b>	<b>430</b>	<b>7,781</b>

5.2.2. Full details of new capital schemes can be found in report C17/10, which provides details of the new capital bids included in the above table.

5.2.3. Table 2 below summarises the above capital expenditure plans and how they are being financed by capital or revenue resources. Any shortfall of resources would result in a funding borrowing need.

**Table 2 Capital expenditure financing**

<b>£'000</b>	<b>2016/17 Original Budget</b>	<b>2016/17 Revised Budget</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>Total</b>
<b>Financed by:</b>						
Capital receipts	1,813	610	1,183	995	0	<b>2,807</b>
Capital grants	560	529	546	290	290	<b>1,510</b>
Reserves	86	140	1,640	0	0	<b>2,171</b>
Innovation and investment fund	195	381	617	0	0	<b>399</b>
Revenue	1,019	0	280	140	140	<b>560</b>
Borrowing	0	0	0	0	0	<b>0</b>
<b>Net financing need for the year</b>	<b>3,673</b>	<b>1,660</b>	<b>4,266</b>	<b>1,425</b>	<b>430</b>	<b>7,781</b>

5.2.4. The current programme is fully financed with no need to borrow at present, however this could change depending on the progress of major projects such as Elstree and Newberries developments as detailed in paragraph 5.8.3.

### 5.3. The Council's borrowing need (The Capital Financing Requirement)

5.3.1. 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 funded from either revenue or capital resources after taking into account adjustment A (refer to paragraph 5.3.4 below). It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above (paragraph 5.2.1), which has not immediately been funded, will increase the CFR.

5.3.2. The CFR does not increase indefinitely as the Council is required to set aside an amount each year from revenue to finance historical capital expenditure that was not financed in the year it was incurred. This minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets expected useful life.

5.3.3. **Table 3 - The Council is asked to approve the CFR projections below:**

<b>CFR projections £000's</b>	<b>2015/16 Actual</b>	<b>2016/17 Original Budget</b>	<b>2016/17 Revised Budget</b>	<b>2017/18 Est.</b>	<b>2018/19 Est.</b>	<b>2019/20 Est.</b>
Previous Year CFR B/Fwd	9,930	5,932	5,932	5,690	6,448	6,206
Movement in CFR in the Year	(3,998)	(282)	(242)	758	(242)	(242)
<b>Total CFR</b>	<b>5,932</b>	<b>5,650</b>	<b>5,690</b>	<b>6,448</b>	<b>6,206</b>	<b>5,964</b>

5.3.4. The CFR in the previous year's Treasury Management strategies (original estimates) had been shown as a nil balance. However in technical terms the Council always had a CFR of £9.93M prior to 2015/16, which dates back to a change in accounting practice in 2007 and represents unfunded capital spend as at that date which could not be classified against individual Council assets and was known in accounting terms as "adjustment A". For Hertsmere the "adjustment A" likely relates to the Council's Leisure Centres now managed under full repairing leases by Hertsmere Leisure Trust and whilst revenue resources have been set aside to fund these historic costs they have been held in a revenue reserve rather than a set aside capital reserve. Historically the CFR figure was calculated less the "adjustment A", as allowed under Capital Accounting guidance, hence why the CFR was previously been shown as a nil balance.

5.3.5. This position was reviewed during 2015/16 and given that Hertsmere is now looking at significant capital investment in the near future, which will require some borrowing increasing the Council's CFR and mindful of the Prudential Code's guidance on affordability, a voluntary contribution of £4m was set aside to reduce the CFR to £5.9m. The remaining CFR of £5.9m will now be written down through MRP via an ongoing contribution from revenue which is already part of the base revenue budget.

- 5.3.6. There is an increase in CFR forecast for 2017/18 as a result of a £1m repayment relating to the Local Authority Mortgage Scheme (LAMS). The council previously placed £1m into a 5 year fixed term deposit with Lloyds to match the 5 year indemnity provided under the scheme. At the same time £1m was set aside from the general fund, temporarily decreasing the CFR. When the loan is repaid in 2017/18 this will reverse this adjustment.
- 5.3.7. Projects such as Newberries Car park development and the Elstree Film studios back lot development have not been included within the above projections. Once these projects have been formally agreed following initial feasibility works and included within the Capital programme then the CFR may need to increase and further MRP required as Capital reserves are likely to be insufficient to finance these projects.
- 5.3.8. It is likely that the Council will seek to fund the EFS development from future revenue streams arising from the project, which so far has been financed through reserves.



#### 5.4. **Minimum Revenue Provision (MRP) policy statement**

- 5.4.1. The Council is required to pay off an element of the accumulated unfunded capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
- 5.4.2. The Communities and Local Government (CLG) regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. Councils are required to determine each year an amount of MRP which they consider to be prudent. CLG provides statutory guidance as to how it considers this duty can be met, but the guidance is not binding if alternative arrangements result in a prudent outcome. The Council is recommended to approve the following MRP Statement.
- 5.4.3. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
- **Option 1 – Regulatory Method** - MRP will follow the existing practice outlined in former CLG regulations (i.e. CFR is calculated after Adjustment A) However as detailed in paragraph 5.3.4 the council set aside a voluntary MRP adjustment of c£4m for 2015/16. The remaining CFR balance of £5.9M will be written down through an annual MRP from 2016/17 onwards.
- 5.4.4. From 1 April 2008 for all unsupported borrowing the MRP policy will be:
- **Option 3 - Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).
- 5.4.5. These options provide for a reduction in the borrowing need over approximately the asset's life.
- 5.4.6. The Council is not required to make an MRP contribution until the financial year following completion of development.

**5.5. Core funds and expected investment balances**

5.5.1. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

**Table 4 – Investment balance forecast**

<b>Year End Resources £m</b>	<b>2016/17 Forecast</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
Total core funds	28.8	27.6	25.0	24.0
Working capital	15.0	14.0	13.0	13.0
<b>Expected investments</b>	<b>43.8</b>	<b>41.6</b>	<b>38.0</b>	<b>37.0</b>

5.5.2. The expected level of investment balances beyond the forthcoming year can be difficult to forecast as they are affected by fluctuations in working capital balance which are only available on a temporary basis. Should the Council decide not to borrow and instead utilise internal reserves and cash balances to finance part or all of schemes such as the Elstree Studios and Newberries developments the level of core funds will be reduced accordingly.

**5.6. Affordability prudential indicators**

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

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

5.6.3. **Incremental impact of capital investment decisions on council tax.** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council’s existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates.

**Table 5 –Affordability indicators**

	<b>2015/16 Actual</b>	<b>2016/17 Forecast</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
<b>Ratio of financing costs to net revenue</b>	(3.01%)	(2.26%)	(1.65%)	(1.58%)	(1.58%)
<b>Incremental impact of capital investment decisions on council tax</b>	£0.50	£0.22	£0.60	£0.30	£0.17

5.6.4. The above table does not include any borrowing that may be required in relation to the Newberries and Elstree Studio projects as detailed in paragraph 5.5.2.

## 5.7. Borrowing Projections

5.7.1. The Council's anticipated Treasury position at 31 March 2017, with forward projections are summarised below.

**Table 6 – borrowing projections**

£m	2016/17 Original Estimate	2016/17 Revised Forecast	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
<b>Actual gross debt at 31 March</b>	0	0	0	0	0
<b>The Capital Financing Requirement</b>	5,650	5,690	6,448	6,206	5,964
<b>Under / (over) borrowing</b>	<b>5,650</b>	<b>5,690</b>	<b>6,448</b>	<b>6,206</b>	<b>5,964</b>

5.7.2. As detailed in 5.3 the CFR figures have been adjusted to include the adjustment A figure.

5.7.3. 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 the forthcoming financial year and the following two financial years. Paragraphs 5.3.5 indicates that the CFR will increase further in the near future, subject to the Council approving phase 2 of the Elstree Film Studios project and Newberries Car park developments.

5.7.4. On that basis, the Director of Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report C17-10.

**5.8. Treasury indicators: Limits to borrowing activity**

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

5.8.2. **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. 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.
2. The Council is asked to approve the following authorised limits:

**Table 7 –Authorised borrowing Limits**

£m	2016/17	2017/18	2018/19	2019/20
<b>Operational Boundary</b>	18	28	28	28
<b>Authorised Limit</b>	20	30	30	30

**Borrowing strategy**

5.8.3. The Council may need to borrow in order to fund its planned major projects, the EFS backlot and Newberries Car park developments, subject to the initial viability works and planning approval already underway. The exact timing will depend on the project timescales, projected borrowing rates and cashflow requirements. The limits above reflect the fact that borrowing is possible should these two schemes go ahead.

**Municipal Bond Agency**

5.8.4. It is likely that the Municipal Bond Agency, currently in the process of being set up in conjunction with the Local Government Association (LGA), will be offering loans to local authorities in the near future. It is hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLb). The Council has committed to placing £20k toward the initial set up of this enterprise through the purchase of shares and intends to make use of this new source of borrowing as and when appropriate assuming rates are competitive.

### **Public Works Loan Board (PWLB)**

- 5.8.5. The PWLB currently provide the lowest borrowing rates available to Local Authorities as well as being easily accessible, loans can be arranged the same day potentially. The council has secured the “Certainty rate” which offers a 0.20% reduction to the PWLB normal rates. Whilst PWLB rates are at an historic low careful consideration needs to be given as to the timing of any borrowing to ensure that the cost carry does not outweigh the benefits of low rates.

**5.9. Treasury management limits on activity**

5.9.1. 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 can impair the opportunities to reduce costs/improve performance. The indicator limits 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. The Council is asked to approve the following treasury indicators and limits:

**Table 8 – Interest rate exposure limits**

<b>Interest rate exposures</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Borrowing - Variable</b>	30%	30%	30%
<b>Borrowing -Fixed</b>	100%	100%	100%
<b>Investments –Variable</b>	75%	75%	75%
<b>Investments - Fixed</b>	100%	100%	100%
<b>Maturity structure of fixed interest rate borrowing 2016/17</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	
<b>Maturity structure of variable interest rate borrowing 2016/17</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	

**5.10. Policy on borrowing in advance of need**

5.10.1. 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.

**5.11. Treasury management: Principal sums invested and maturity**

5.11.1. This indicator shows the maximum the Council expects to invest for periods longer than 364 days at any point in time and the maturity structure of those investments. It shows the Council's exposure to the possibility of loss that might arise as a result of it having to seek early repayment or redemption of principal sums invested.

**Table 9 – Investments limits beyond 1 year**

Maximum principal sums invested > 365 days			
£m	2017/18	2018/19	2019/20
Principal sums invested > 364 days	£15m	£15m	£15m



## 6. Current Portfolio Position

6.1. The weighted average investment portfolio from April 2016 to November 2016 is £45.9m with an average return of 0.67%. Listed below are the average investment balances and the rate of return for the financial year 2016/2017 up to November 2016 together with a comparison of the position at 2016/17 year end.

**Table 10 – Average return on investments**

<b>Investment Portfolio</b>	<b>01 April 15 to 31 March 16</b>	<b>01 April 16 to 30 Nov 2016</b>
Average Balance	£36.5m	£45.9m
Average rate of return	0.81%	0.67%

6.2. As detailed below the current year forecast predicts a favourable variance of £50k by year end. (March 2017)

**Table 11 – Investment income forecast**

	<b>Investment Average balance</b>	<b>Interest</b>	<b>Rate</b>
<b>Forecast:</b>	<b>£'000</b>	<b>£'000</b>	<b>%</b>
Budget	28,500	220	0.77%
Forecast to 31/03/17	43,600	270	0.62%
<b>Forecast favourable / (adverse) variance</b>	<b>15,100</b>	<b>50</b>	<b>-0.15%</b>

6.3. The forecast interest surplus has arisen as a result of having greater than anticipated balances available to invest throughout 2016/17. This has arisen in part due to:

- Prudent and conservative budgeting of investment income.
- Delayed or re-profiled capital spend.
- Provisions in final accounts which have yet to materialise in cash terms.

6.4. The investment portfolio is expected to reduce from approximately £54.2m at the end of November to £43.8m by the 31<sup>st</sup> March 2017 inclusive of approx. £8.8m of Section 106 and Community Infrastructure balances. This is due to the cash flow requirements of the councils such as Council tax and Business rates income being paid over the first ten months of the year thus reducing investment balances in the final two months of the year.

## **7. Annual Investment Strategy**

### **7.1. Investment Policy**

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

- (a) the Security of capital;
- (b) the Liquidity of its investments; and
- (c) the Yield.

7.1.2. The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

7.1.3. The risk of default remains a concern; if 10% of the Council's portfolio of £36.5m as at 31 March 2015 were to default then the potential loss could be £3m – £4m. The Council has managed the risk by only investing in financial institutions with good credit ratings and those part owned by the UK Government.

### **7.2. Interest rate expectations**

7.2.1. Bank Rate is currently forecast to stay flat at 0.25% until quarter 2 2019, then rising to 0.5% with no further increase forecast until quarter 1 2020. Bank Rate forecasts for financial year ends (31 March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

7.2.2. The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

### 7.3. Types of Investments

- 7.3.1. As detailed in the Treasury Code of practice “Local authorities are not constrained by law in the types of investments they may make or the investment instruments they may use”. However in practice they are constrained by DCLG guidance which stresses “the prudent investment strategy of security, liquidity and yield”. Investment regulations and DCLG guidance also “distinguish between ‘specified’ and ‘non-specified’ investments, the latter requiring greater scrutiny by local authorities”.
- 7.3.2. Investment instruments identified for use in the financial year are listed below under the ‘specified’ and ‘non-specified’ investment categories.
- 7.3.3. **Specified Investments** - The Council will invest in “specified” investments that meet the criteria of a “specified” investment as detailed in the DCLG guidance. These will be those that will have high security and high liquidity, denominated in sterling and not a long term investment i.e. maturity date of no more than 12 months. The investment is not defined as capital expenditure.

The specified investments in which the Council can invest in are:

- The UK Government
- Debt Management Office Accounts
- UK Local Authorities and Parish Councils
- Term deposits with institutions or investment schemes with a credit rating that meets the criteria detailed in section 8.
- Money Market funds with AAA rating
- Enhanced Money market funds with AAA rating

- 7.3.4. **Non-specified Investments** - The Council’s policy is to invest in non-specified investments, which meet all the criteria of the specified investments above. This includes but is not limited to term deposits and Certificates of deposit issued by banks or building societies and deposits beyond 12 months which meet the criteria as set out in the investment strategy below.
- 7.3.5. The Council will place deposits in accordance with the Capita Asset Service matrix recommended colour durations, and where possible spread the amounts and dates of maturing investments as evenly as possible over this period. This avoids an excess of investments maturing in any one particular time and helps towards a more stable rate of return.

#### 7.4. Creditworthiness policy

7.4.1. This Council uses the creditworthiness service provided by Treasury consultants; Capita Asset Services. This service has been progressively enhanced over recent years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

7.4.2. 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

7.4.3. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour not to be used

7.4.4. All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Service 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 immediately. Consideration will also be given to terminating existing investments where appropriate.
- 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.

- 7.4.5. 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 from credible sources such as financial times, information on government support for banks and the credit ratings of that government support.

**7.5. Counterparty and Group Limits**

7.5.1. As well as using the Capita Asset Service matrix, the Council will limit its exposure to any one particular Institution or group of banks, for example the Lloyds Group and Santander Group. The Council will adopt a tiered exposure using Fitch long term (or equivalent from other agencies if Fitch does not provide) to determine the amount of funds placed with each institution. The DMO account, UK Government and Local Authorities and UK part nationalised banks will have a separate limit of £10m. Money market funds will have a credit limit of £8m per fund.

**7.6. Time and monetary limits applying to investments.**

7.6.1. The time and monetary limits for institutions on the Council’s counterparty list are as follows (these will cover both specified and non-specified investments):

**Table 12 – Investment limits**

	<b>Fitch Long term Rating (or equivalent)</b>	<b>Money and/or % Limit</b>	<b>Time Limit</b>
<b>Higher Quality Rated Banks</b>	<b>AAA AA+ AA, AA-</b>	<b>£8m</b>	<b>As per Capita recommended duration.</b>
<b>Medium Quality Rated Banks</b>	<b>A+ A</b>	<b>£4m</b>	<b>As per Capita recommended duration.</b>
<b>UK Medium Quality Rated Banks</b>	<b>A+ A</b>	<b>£6m</b>	<b>As per Capita recommended duration.</b>
<b>Part nationalised* (Currently only RBS/Natwest fall into this category)</b>	<b>N/A</b>	<b>£10m</b>	<b>As per Capita recommended duration – Currently 1yr</b>
<b>Barclays Bank – Council’s banker.</b>	<b>XXX</b>	<b>£5m</b>	<b>Daily limit</b>
<b>DMADF</b>	<b>AAA</b>	<b>unlimited</b>	<b>5yrs</b>
<b>Local authorities</b>	<b>N/A</b>	<b>£10m</b>	<b>5yrs</b>
<b>Money market funds</b>	<b>AAA</b>	<b>£8m</b>	<b>liquid</b>
<b>Enhanced Money market funds</b>	<b>AAA</b>	<b>£8m</b>	<b>liquid</b>

7.6.2. The council will endeavour to diversify its investment portfolio by country, group and institution. However, the Council may decide to limit counterparty diversification by

investing in Countries such as the UK, Canada and Australia where there is greater understanding about economy and Government intention such as desire to support institutions from defaulting.

## 7.7. **Sovereign limits**

7.7.1. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA (or equivalent from other agencies if Fitch does not provide). This list will be added to, or deducted from; by officers should ratings change in accordance with this policy. However this does not extend to the UK which is currently rated AA+ by Fitch.

## 7.8. **Current AAA Rated Countries by Fitch:**

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland

No more than 30% of the total portfolio is to be invested in any one country, except the UK.

## 7.9. **Money Market Funds (MMF)**

7.9.1. Money market funds are mutual funds that invest in short-term debt instruments. They provide the benefits of pooled investment, as investors can participate in a more diverse and high-quality portfolio than they otherwise could individually. Like other mutual funds, each investor who invests in a money market fund is considered a shareholder of the investment pool, a part owner of the fund. Money market funds are actively managed within rigid and transparent guidelines to offer safety of principal, liquidity and competitive sector-related returns.

## 7.10. **Enhanced Money Market Funds**

7.10.1. These are similar to Money market funds in that they use pooled cash to invest into various products and counterparties. In order to be classified and rated as a MMF the fund is required to adhere to strict rules regarding the investment types and average days until maturity of the portfolio. Enhanced funds can vary but will generally be slightly longer dated which means they lose their MMF categorisation. The rating of the funds can vary as they are not constrained by the MMF classification however the council will only use enhanced money market funds which are AAA rated. Although these fund are highly liquid as funds can be redeemed within 2-3 days they are designed to be invested for 6 to 12 months as there can be some volatility in the yield.

### 7.11. **Main Bankers - Barclays**

- 7.11.1. Currently the council utilises Money Market funds for short term liquidity purposes, however each payment transaction is subject to a chaps charge (bank charge). It is therefore proposed that in addition to the limits set under the main investment strategy, Barclays as our main banker will be further utilised for liquidity purposes. This will involve having balances of up to £5m held in the council business premium account through the use of the banks sweeping system thus avoiding bank charges.
- 7.11.2. **The Local Authority Mortgage Scheme (LAMS)** – The Council is currently participating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This investment is an integral part of the policy initiative and is outside the criteria above.

## 8. **Alternative approach**

- 8.1. The investment strategy approach set out in section 7 above is a risk adverse strategy that the Council have chosen to adopt in recent years following the banking crisis. The current strategy utilises only the highest credit rated investments with the emphasis on the security and liquidity of investments. The Council could potentially achieve higher yield levels by investing in the following investments but this would involve the Council taking additional levels of risk:
- Bond Funds
  - Gilt Funds
  - Unrated/Lower rated building societies
  - Property Funds
  - Share Capital in corporate body (Deemed capital expenditure)
- 8.2. As these types of investments would be considered “non-specified” they would require a greater level of scrutiny to ensure that the appropriateness and associated risks are fully understood.
- 8.3. The Audit Committee were requested to consider whether the current risk averse approach is still appropriate or whether alternative, higher risk, investments should also now be included in the Council's Annual Investment Strategy. The Committee have recommended that the Council approve the Annual Investment Strategy set out in section 7.
- 8.4. The Audit Committee have however requested that further consideration be given to the use of unrated/lower rated Building Societies and further information on these will be presented to the Committee at their next meeting in May 2017. It is therefore recommended that authority be delegated to the Audit Committee to decide whether or not to include the use of unrated/lower rated Building Societies in the Treasury Management Strategy 2017/18.



## **9. Risk Implications**

### **9.1. Monitoring**

- 9.2. On a Quarterly basis Officers will report to Financial Monitoring Panel providing details of new investments, rate of returns and highlighting changes to sovereign rating, group limits and any other relevant treasury issues that may arise.

## **10. Treasury Management scheme of delegation**

### **(i) Full Council**

- receiving and reviewing reports on Treasury Management strategy and policy
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, and treasury management practices
- approval of the division of responsibilities

### **(iii). Audit Committee**

- scrutiny of/amendments to the organisation's adopted clauses, and treasury management practices
- scrutiny of the division of responsibilities

### **(iv) Financial Monitoring Panel**

- Scrutiny of Treasury Management Performance
- receiving and reviewing regular monitoring reports and scrutinising on-going Treasury Management performance.

### **(v) Director of Resources**

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

## **11. The Treasury Management role of the section 151 officer**

### **The S151 (responsible) officer**

- 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.