

**Report of the Section 151 Officer**

**Council – 25 February 2016**

**TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS,  
INVESTMENT STRATEGY  
AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2016/17**

<b>Purpose:</b>	To recommend the Treasury Management Strategy Statement, Prudential Indicators, Investment Strategy and Minimum Revenue Provision Policy Statement for 2016/17.
<b>Policy Framework:</b>	None
<b>Reason for Decision:</b>	To allow for the proper management of the Council's borrowing and investments, to comply with statute, and the adopted CIPFA Prudential Code for Capital Finance in Local Authorities and the Revised CIPFA Treasury Management Code of Practice
<b>Consultation:</b>	Legal, Finance & Delivery and Access to Services.
<b>Recommendations:</b>	That Council approves the:-  (1) Treasury Management Strategy and Prudential Indicators (Sections 2-7) and  (2) Investment Strategy (Section 8) and  (3) Minimum Revenue Provision (MRP) Statement (Section 9)
<b>Report Author:</b>	Jeffrey Dong
<b>Finance Officer:</b>	Mike Hawes
<b>Legal Officer:</b>	Tracey Meredith
<b>Access to Services Officer:</b>	Sherill Hopkins

**1. Introduction**

1.1 This strategy statement has been prepared in accordance with the revised CIPFA Treasury Management Code of Practice adopted by this Council in 2010. The Council's Treasury Management Strategy will be received and reviewed annually by Council and there will also be a mid year report providing an interim update. The aim of these

reporting arrangements is to ensure that those with ultimate responsibility for the scrutiny of the Treasury Management function appreciate 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.

## 1.2 Revised CIPFA Prudential Code

CIPFA has issued a revised Prudential Code which primarily covers borrowing and the Prudential Indicators. Three of these indicators have now been moved from being Prudential Indicators to being Treasury Indicators: -

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

However, all indicators are to be presented together as one suite. In addition, where there is a significant difference between the net and the gross borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy report.

## 1.3 The Local Government Act 2003 requires the Council to have regard to the Prudential Code and to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Council is required to formally consider the Prudential and Treasury Indicators as detailed in section 2 of this report

## 1.4 The Act also requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy as required by Investment Guidance issued subsequent to the Act. This strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The management of the Council's Treasury Management activities are in line with the CIPFA Treasury Management Revised Code of Practice.

## 1.5 The recommended strategy for 2016/17 is based upon a view on interest rates, having considered leading market forecasts provided by the Council's treasury advisor, Capita Asset Services. The overall strategy covers:

- Treasury Limits 2016/17-2019/20
- Prudential / Treasury Indicators
- The current portfolio position
- Prospects for interest rates including a summary of the economic background
- The Borrowing Requirement
- The Borrowing Strategy
  - Gross v Net Debt Position

- Policy on Borrowing in Advance of Need
- Debt Rescheduling
- The Annual Investment Strategy
  - Investment Policy
  - Interest Rate Outlook
  - Creditworthiness Policy
  - Country Limits
  - Policy on the Use of External Advisors
  - Scheme of Delegation
  - Pension Fund Cash
- Minimum Revenue Provision (MRP) Policy Statement

1.6 A glossary of terms used within this report is attached at Appendix A.

## **2. Treasury Limits 2016/17 to 2019/20**

2.1 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to set a balanced budget. 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 means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

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

are affordable within the projected income of the Council for the foreseeable future.

2.2 Under statute, the Council is required to set an Affordable Borrowing Limit i.e a limit which the Council can afford to borrow. In Wales, the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

2.3 The Council must have regard to the Prudential Code when setting the Authorised Limit . This limit requires the Council to ensure that total capital investment remains within sustainable limits. The Authorised Limit must be set for the forthcoming financial year and the two successive financial years.

2.4 The Prudential Code for Capital Finance in Local Authorities requires Councils to calculate treasury indicators (formerly prudential indicators) which demonstrate prudence in the formulation of borrowing proposals. These are defined as:

- The Operational Boundary :  
*"...is based on expectations of the maximum external debt*

*of the authority according to probable not simply possible events and being consistent with the maximum level of external debt projected by the estimates....”*

- The Authorised Limit :  
*“..the Authorised Limit must therefore be set to establish the outer boundary of the local authority’s borrowing based on a realistic assessment of the risks. The authorised limit is certainly not a limit that an authority will expect to borrow up to on a regular basis. It is crucial that it is not treated as an upper limit for borrowing for capital expenditure alone since it must also encompass borrowing for temporary purposes...”*
- Upper limits for borrowing of fixed and variable rate loans.
- Upper limit for investments for over 364 days.
- Upper and lower limits for the maturity profile of the Council’s debt
- Estimates of the incremental impact of capital investment decisions on Council Tax / Housing rents
- Estimates of the ratio of financing costs to net revenue stream
- Estimates of the capital financing requirement

2.5 In setting and revising Prudential Indicators the authority is required to have regard to:-

- Affordability e.g. implications for Council Tax / Housing rents
- Prudence and sustainability e.g. implications for external borrowing
- Value for money e.g. option appraisals
- Stewardship of assets e.g. strategic planning
- Practicality e.g. achievability of forward plans

2.6 It is a requirement of the Code that Prudential / Treasury Indicators are regularly monitored and systems are in place to achieve compliance.

<b>Treasury / Prudential Indicators</b>						
	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
	<b>Actual</b>	<b>Probable</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
<b>Capital Expenditure</b>						
GF	67,169	72,063	54,863	19,868	17,329	13,170
HRA	24,582	122,475	55,000	45,500	44,500	52,000
<b>TOTAL</b>	<b>91,751</b>	<b>194,538</b>	<b>109,863</b>	<b>65,368</b>	<b>61,829</b>	<b>65,170</b>
<b>Capital Financing Requirement 31<sup>st</sup> March***</b>						
GF	333,683	339,080	344,735	339,277	332,539	327,399
Credit Arrangements *	2,472	2,218	1,451	893	484	236
HRA	63,485	143,139	154,345	164,692	172,833	186,810
Magistrates' Court **	1,531	1,470	1,411	1,354	1,300	1,248
<b>TOTAL</b>	<b>401,171</b>	<b>485,907</b>	<b>501,942</b>	<b>506,216</b>	<b>507,156</b>	<b>515,693</b>
<b>Authorised limit for external debt</b>	£500,561	£606,216	£607,156	£615,693	£615,693	£615,693
<b>Operational boundary for external debt</b>	£454,260	£546,216	£547,156	£555,693	£555,693	£555,693
<b>Upper limit for fixed interest rate exposure</b>	100%/ £500,561	100%/ £606,216	100%/ £607,156	100%/ £615,693	100%/ £615,693	100%/ £615,693
<b>Upper limit for variable rate exposure</b>	40%/ £200,224	40%/ £242,486	40%/ £242,862	40%/ £246,277	40%/ £246,277	40%/ £246,277
<b>Upper limit for total principal sums invested for over 364 days</b>	40,000	40,000	40,000	40,000	40,000	40,000

\* The GF Capital Financing Requirements includes arrangements classified as credit arrangements (finance leases) under International Financial Reporting Standards (IFRS) requirements as of 2011/12. However these continue to be funded directly on a revenue basis and do not form part of the borrowing requirement.

\*\* Legacy Magistrates' Court debt which is wholly recharged is included for completeness

\*\*\* Excludes potential additional borrowing if forecast capital budget shortfalls cannot be resolved in future years

<b>Maturity structure of fixed rate borrowing during 2014/16-2019/20</b>		
	<b>Upper limit %</b>	<b>Lower limit %</b>
Under 12 months	50	0
12 months and within 24 months	50	0
24 months and within 5 years	50	0
5 years and within 10 years	85	0
10 years and above	95	15

<b>Ratio of Financing Costs to Net Revenue Stream</b>						
	<b>Actual 2014/15 %</b>	<b>Revised 2015/16 %</b>	<b>Estimate 2016/17 %</b>	<b>Estimate 2017/18 %</b>	<b>Estimate 2018/19 %</b>	<b>Estimate 2019/20 %</b>
<b>General Fund</b>	7.96	6.89	7.01	7.23	7.45	7.68
<b>HRA</b>	8.01	13.07	13.33	15.96	16.03	16.18

<b>Estimates of Incremental Impact of Capital Investment Decisions on Council Tax (Band D) and Council Housing Rents</b>						
	<b>Actual 2014/15 %</b>	<b>Revised 2015/16 %</b>	<b>Estimate 2016/17 %</b>	<b>Estimate 2017/18 %</b>	<b>Estimate 2018/19 %</b>	<b>Estimate 2019/20 %</b>
<b>General Fund*</b>	86.94	79.13	80.91	100.81	112.05	116.28
<b>HRA*</b>	0.00	0.00	104.64	194.06	266.31	357.86

\*It should be noted that in formulating the two above indicators it is necessary to hypothecate funding (in this case council tax and housing rents) to specific areas of capital expenditure, however in reality the full allowable spectrum of funding resource is utilised in funding capital expenditure as appropriate.

#### Gross Debt v Capital Financing Requirement

The gross debt position versus the capital financing requirement is detailed below. The profile below assumes progressive external funding of the internalised borrowing and the budgeted use of reserves as profiled in the revenue budget report.

<b>Comparison of average gross debt and capital financing requirement</b>	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
	<b>actual</b>	<b>probable</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Average debt (gross)</b>	312,230	365,856	401,938	420,481	439,054	457,654
<b>Capital Financing Requirement at 31<sup>st</sup> March (Borrowing)</b>	398,699	483,689	500,491	505,323	506,672	515,457
<b>Net Position</b>	86,469	117,833	98,553	84,842	67,618	57,803

### 3 . The current portfolio position

3.1 The Council's probable debt portfolio position at 31/3/16 comprises:

	<b>Principal outstanding 31 March 2016 £'000</b>	<b>Average rate of Interest %</b>
Public Works Loan Board (fixed)	283,080	5.55
Money Market	98,000	4.10
Temporary	2,349	0.69
<b>TOTAL</b>	<b>383,429</b>	<b>5.16</b>

3.2 The Council's forecast investment portfolio at 31 March 2016 is as follows:

<b>Managed Investments</b>	<b>Investments 31 March 2016 £'000</b>	<b>2015/16 Probable Investment Return %</b>	<b>2016/17 Estimated Investment Return %</b>
Internally Managed	55,574	0.54	0.60

### 4. Prospects for Interest Rates

4.1 The Council's Treasury advisers (Capita Asset Services) provided the following interest rate forecast for both short term ( bank rate) and long term (PWLb) interest rates as at 16<sup>th</sup> January 2016. There is a downside risk to these forecasts if economic growth proves to be weaker and slower than currently forecast.

Capita Asset Services Interest Rate View														
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB View	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB View	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%

#### 4.2 Economic Background

Attached at Appendix B is an economic background assessment provided by our Treasury advisers, Capita Asset Services. This assessment has informed the proposed strategies .

## 5. The Borrowing Requirement

5.1 The Council will have the following net capital borrowing / repayment requirements for 2015/16 to 2019/20 :

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>Borrowing and repayment requirements</b>	<b>Actual</b>	<b>Probable</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
To finance new capital expenditure by supported borrowing	6,297	6,356	6,356	6,356	6,356	6,356
To finance new capital expenditure supported by Local Authority Government Borrowing Initiative (highways/21 <sup>st</sup> Century Schools)	4,489	3,421	3,000	1,450	-	-
To finance new capital expenditure by unsupported borrowing	25,969	12,311	10,955	1,778	1,912	2,928
To finance HRA capital expenditure/HRA Subsidy Reform 2015/16		78,035	20,000	15,000	13,000	19,000
To replace loans maturing/repaid prematurely	7,323	3,189	286	9,002	1	1
Less						
Repayments (MRP)	14,726	15,532	15,958	16,687	16,887	16,496
Set aside capital receipts	1,566	600	600	600	600	600
<b>NET BORROWING /(REPAYMENT) REQUIREMENT</b>	<b>13,140</b>	<b>80,802</b>	<b>24,039</b>	<b>16,299</b>	<b>3,782</b>	<b>11,189</b>
Principal repayment element of finance lease payments	915	843	577	410	325	133

5.2 The above table details the net borrowing requirement for each financial year. In accordance with the Prudential Code, borrowing must be undertaken in line with a funding plan informed by the projected capital financing requirement. Borrowing may be financed from one or more of Public Works Loan Board loans; Money Market loans or internal loans. The precise choice will depend on market conditions from time to time.

5.3 At time of writing, borrowing rates are materially higher than investment rates as has been the case since the onset of the financial crisis, considering this it has been determined that in the main the borrowing requirement for the capital programme shall be met by internalising the borrowing. However, as cashflow constraints and prospects for interest rate rises remain, we shall commence averaging in the borrowing requirement in the latter part of 2015/16 and forthcoming financial years to fund the capital programme when borrowing rates offer long term value .



Short term savings (by avoiding material new long term external borrowing) will be weighed against the potential additional long term extra costs (by delaying unavoidable new external borrowing until later when PWLB long term rates are forecast to be marginally higher).

#### 5.4 Housing Revenue Account (HRA) Subsidy Reforms - Self Financing Settlement

As outlined in the report approved by Council on 2<sup>nd</sup> Dec 2014 entitled "*Reform of the Housing Revenue Account Subsidy System*", the Authority has entered into a Voluntary Agreement with Welsh Government to exit the current HRA subsidy system, resulting in more flexibility for the Authority in meeting affordable housing needs in the locale. In order to exit the current HRA subsidy system, a cash settlement amount had to be paid over to HM Treasury equal to a sum determined by formulae agreed in the Voluntary Agreement which resulted in a settlement figure of £73.58m for this Authority. The overriding principle of the HRA Reform is that all local housing authorities will be financially better off in revenue terms after the reforms.

5.5 The HRA reform settlement was required to be made to the Welsh Government on 1 April 2015 which was subject to a separate borrowing strategy dictated by the terms outlined in the Voluntary Agreement. The Council borrowed £73.58m from the PWLB and remitted this total amount to Welsh Government on April 2<sup>nd</sup> 2015.

5.6 The servicing and amortisation of this pool of debt shall be managed completely separately from the remainder of the debt portfolio and recharged directly to the HRA.

### **6. Borrowing Strategy**

6.1 Long term borrowing rates are expected to be significantly higher than rates available for investment deposits. It is likely that this position will pertain in the short to medium term.

In addition, the continuing uncertain economic conditions has maintained the need for caution in managing credit counterparty risk. There is still a risk of a bank / institution defaulting on the payment of interest due or repayment of amounts invested.

At the current time, long term PWLB and market rates offer attractive funding opportunities and some borrowing may be taken in the short to medium term to average in the long term borrowing requirement demanded by the council's capital programme reported separately on this agenda and to address cash flow requirements.

6.2 However, the overall strategy - with a view to minimising interest costs and the risk of default by counterparties - is therefore to continue to internalise the majority of the borrowing requirement for the capital programme with a view to averaging in the remainder of the borrowing requirement as cashflow and interest rates dictate in the medium term.

#### 6.4 Policy on borrowing in advance of need

The Council has only a limited power to borrow in advance of need.

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

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to borrow in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and which repayment profiles to use.

### **7 Debt Rescheduling**

7.1 The introduction of different PWLB rates on 1 November 2007 for new borrowing (as opposed to early repayment of debt) and the setting of a spread between the two rates (of about 0.4%-0.5% for the longest period loans narrowing down to 0.25%-0.30% for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date.

7.2 Due to short term borrowing rates being expected to be cheaper than longer term rates, there may be 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 their short term nature and the likely cost of refinancing short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any rescheduling needs to be considered net of any premium payable which in light of current interest rates is likely to be considerable.

7.3 In actively managing credit counterparty and interest rate risks, consideration will also be given to running down investment balances by repaying debt prematurely as short term rates on investments are likely to be significantly lower than rates paid on current debt.

However, a repayment strategy will only be considered if a loan repayment offers value in terms of discount / associated costs and does not compromise the Council's long term debt management policies. In this respect, we will need to be mindful of the potential future need to arrange new long term loans as market conditions change from time to time.

7.4 Notwithstanding the above, it is not envisaged that there will not be any debt rescheduling opportunities in the remainder of 2015/16 or 2016/17 in the PWLB portfolio, however there may be opportunities to review the Authority's market debt dependent upon counterparty appetite. All rescheduling decisions will be reported to the Cabinet Member for Finance & Strategy & Strategy in the quarter following action.

## 8. The Annual Investment Strategy

### 8.1 Investment policy

8.1.1 The Council will have regard to the National Assembly of Wales' Guidance on Local Government Investments ("the Guidance") issued in March 2004 (and subsequent amendments); CIPFA's Revised Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code") and the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2004 SI 1010(W.107). The Council's investment priorities are: -

- (a) to ensure the security of capital
- (b) to ensure the liquidity of investments.
- (c) to maximise interest returns (yield) commensurate with (a) and (b)

The investment strategy will be implemented with security of investment as the main consideration. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

8.1.2 The investment criteria are outlined in Appendix C.

8.1.3 Amendments to the arrangements, limits and criteria detailed in Appendix C may be made by the Head of Finance & Delivery and advised to the Cabinet Member for Finance & Strategy in the quarter following action.

Appendix G is the list of UK financial institutions (counterparties) which satisfy the Council's minimum credit criteria as at 16th January 2016

8.1.4 The Council has retained the services of two external fund managers.. They are Investec Asset Management and Invesco Asset Management-who currently have no Council assets under management - The fund managers shall comply with the Annual Investment Strategy. The fund managers investment criteria are outlined in Appendix C.

8.1.5 It is anticipated that the Council will continue to hold internally managed funds during 2016/17 ensuring a suitable spread of investment risks. The Council has fixed benchmarks against which investment performance will be measured, i.e. 7 day LIBID rate (internally managed).

### 8.1.6 Interest Rate Outlook:

Bank Rate is forecast by the Council's advisors to remain unchanged at 0.5% before starting to rise in quarter 2 of 2016. Bank Rate forecasts as at 31<sup>st</sup> March are:

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 2.00%

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

8.1.7 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (1-3 months) in order to benefit from the compounding of interest. However longer dated deposits will be made with appropriate counterparties if opportunities arise.

8.1.8 During and following the end of the financial year, the Council will report on its investment activity as part of its Mid Term Treasury Management Report and its Annual Treasury Management Report.

## 8.2 Creditworthiness Policy

This Council uses the creditworthiness service provided by our Treasury Management Advisors. This service has been progressively enhanced over the years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies. Fitch, Moodys and Standard & Poors form the core element.

Appendix C outlines the Council's creditworthiness policy. Details of Fitch's short and long term ratings are at Appendix D.

The creditworthiness service 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
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system. 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.

All credit ratings will be monitored regularly with reference to the credit ratings report and updates. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.

There will be no future use of a counterparty/investment scheme which fails the credit rating tests .

In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swaps against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the Council's lending list.

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

### 8.3 Country Limits

The Authority has not made any new overseas deposits for several years. Going forward, extreme caution will be required when considering future opportunities to make overseas investments. There are no plans to make overseas investments at this time.

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

### 8.4 Policy on the use of external advisers

The Council uses the services of an external Treasury Management adviser namely - Capita Asset Services Treasury Management Advisors.

The Council recognises that responsibility for Treasury Management decisions remains with the Council at all times and as such, we will ensure that undue reliance is not placed upon external advisers.

However it is recognised that there is value in employing external advisers in relation to 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.

### 8.5 Scheme of Delegation

The role and responsibilities of the Council, Cabinet Member for Finance & Strategy and the s151 officer are as follows:

#### (i) Council

- to receive and review reports on Treasury Management policies, practices and activities
- to receive and review the annual strategy.
- to receive and review amendments to the Authority's adopted clauses, Treasury Management policy statement
- to consider and approve the annual budget
- to receive and review the division of responsibilities

#### (ii) Cabinet Member for Finance & Strategy

- to receive and review regular briefings/reports

- to receive and review the Treasury Management policy and procedures

(iii) Section 151 Officer

- to recommend clauses, Treasury Management policy for approval
- Implement and keep up to date operational Treasury Management practices
- to review the same regularly and monitor compliance
- to submit regular Treasury Management policy reports
- to submit budgets and budget variations
- to receive and review management information reports
- to review the performance of the Treasury Management function
- to ensure the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function
- to ensure the adequacy of internal audit, and liaise with external audit
- to recommend the appointment of external service providers.

8.6 Pension Fund Cash

The Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 which was implemented on 1st January 2010. Any investments made by the Pension Fund will comply with the requirements of SI 2009 No 393 and will comply with the prevailing City & County of Swansea Treasury Management Policies, Practices and Strategies.

**9. Minimum Revenue Provision Policy Statement**

9.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery. It is inappropriate to charge the entirety of this expenditure in the year in which it is incurred i.e the expenditure benefits more than a single year of account. As such, the resulting costs are spread over several years. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP) which was previously determined under Regulation and now is determined under Guidance.

9.2 Statutory instrument WSI 2008 no.588 section 3 states that “..a local authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent,,”

The previous requirement to make a 2% MRP charge for the Housing Revenue Account share of the Capital Financing Requirement (CFR) is unchanged by this instrument.

9.3 Along with the above duty, the Welsh Assembly Government issued guidance in March 2008 which requires that a Statement on the Council’s Policy for its annual MRP should be submitted to the full Council for review before the start of the financial year to which the provision will relate. The Council is legally obliged to ‘have regard’ to the guidance.

9.4 The Welsh Assembly Government guidance outlined four broad options

to adopt for the calculation of MRP. They are:

- Option 1- Regulatory Method
- Option 2 - Capital Financing Requirement Method
- Option 3 - Asset Life Method
- Option 4 – Depreciation Method

The options are detailed at Appendix F.

9.5 The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09 and will calculate the MRP for 2016/17 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act.

9.6 The major proportion of the MRP chargeable will relate to the more historic debt liability (pre 2008/09) that will continue to be charged at the rate of 4% reducing balance, in accordance with option 1 or 2 of the guidance.

Certain expenditure reflected within the debt liability at 31<sup>st</sup> March 2016 will under delegated powers be subject to MRP under option 3 or 4 which will be charged over a period commensurate with the estimated useful life applicable to the nature of expenditure.

Estimated life periods will be determined under delegated powers having taken professional advice. The Section 151 Officer reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

Going forward, it is proposed that all debt arising from capital expenditure supported by the WG through supported borrowing or the Local Government Borrowing Initiative will be charged MRP in accordance with option 1 or 2 and all other capital expenditure and other 'capitalised' expenditure will be repaid under option 3 as appropriate unless otherwise superceded by any accompanying capitalisation directive/guidance.

## **10 Legal Implications**

10.1 The Authority is under a duty to make arrangements for the proper administration of its financial affairs. Failure to do so will be a breach of that duty. The statutory provisions and guidance imposing such a duty on the Authority are as set out in the main body of the Report.

## **11. Equality Impact Implications**

11.1 There are no equality impact implications arising from this report

**Background papers:** The revised CIPFA Treasury Management Code of Practice 2011

The revised CIPFA Prudential Code for Capital Finance in Local Authorities 2011

**Appendices:**

Appendix A – Glossary of Terms

Appendix B – Treasury Advisors' View On The Economic Background

Appendix C – Investment Criteria and creditworthiness policy

Appendix D – Credit Rating Agency Definitions

Appendix E – Approved Countries for Investment

Appendix F Minimum Revenue Provision Guidance

Appendix G – Approved Internal Counterparty Lending List



## TREASURY MANAGEMENT – GLOSSARY OF TERMS

<b>Annualised Rate of Return</b>	Represents the average return which would have been achieved each year.
<b>Authorised Limit</b> <i>( can also be considered as the affordable borrowing limit)</i>	The authorised limit must be set to establish the outer boundary of the local authority's borrowing based on a realistic assessment of the risks. The authorised limit is certainly not a limit that an authority will expect to borrow up to on a regular basis. It is crucial that it is not treated as an upper limit for borrowing for capital expenditure alone since it must also encompass borrowing for temporary purposes. It is the expected maximum borrowing need, with some headroom for unexpected movement.
<b>Bank Rate</b>	The Official Bank rate paid on commercial bank reserves i.e. reserves placed by commercial banks with the Bank of England as part of the Bank's operations to reduce volatility in short term interest rates in the money markets.
<b>Base Rate</b>	Minimum lending rate of a bank or financial institution in the UK.
<b>Basis Points (bp)</b>	A basis point is 0.01 of 1% (100 bp = 1%)
<b>Borrowing</b>	In the Code, borrowing refers to external borrowing. Borrowing is defined as both:- <ul style="list-style-type: none"> <li>• Borrowing repayable with a period in excess of 12months</li> <li>• Borrowing repayable on demand or within 12months</li> </ul>
<b>Capital Expenditure</b>	The definition of capital expenditure starts with all those items which can be capitalised in accordance with the Statement of Recommended Practice (SORP). To this must be added any items that have/will be capitalised in accordance with legislation that otherwise would not be capitalised. Prudential indicators for current and future years are calculated in a manner consistent with this definition.

<b>Capital Financing Charges (see financing costs also)</b>	These are the net costs of financing capital i.e. interest and principal, premium less interest received and discounts received.
<b>Capital Financing Requirement</b>	The Capital Financing Requirement is simply the total 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.
<b>CIPFA</b>	The Chartered Institute of Public Finance and Accountancy. One of the leading professional accountancy bodies in the UK and the only one which specialises in the public services.
<b>Counterparty</b>	The organisations responsible for repaying the Council's investment upon maturity and for making interest payments.
<b>Credit Rating</b>	<p>This is a scoring system that lenders issue people with to determine how credit worthy they are.</p> <p>The Credit Rating components are as follows:</p> <ol style="list-style-type: none"> <li>1. The AAA ratings through to C/D are long-term rating definitions and generally cover maturities of up to five years, with the emphasis on the ongoing stability of the institution's prospective financial condition. AAA are the most highly rates, C/D are the lowest. This Council does not invest with institutions lower than AA- for investments over 364 days</li> <li>2. F1/A1/P1 are short-term rating definitions used by Moody's, S&amp;P and Fitch Ratings for banks and building societies based on their individual opinion on an institution's capacity to repay punctually its short-term debt obligations (which do not exceed one year). This Council does not invest with institutions lower than F1/A1/P1 for investments under 364 days.</li> </ol>
<b>Debt</b>	For the purposes of the Code, debt refers to the sum of borrowing (see above) and other long-term liabilities (see below). It should be noted that the term borrowing used with the

	Act includes both borrowing as defined for the balance sheet and other long terms liabilities defined as credit arrangements through legislation.
<b>Discounts</b>	Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount. This is calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.
<b>Financing Costs</b>	The financing costs are an estimate of the aggregate of the following:- <ul style="list-style-type: none"> <li>• Interest payable with respect to borrowing</li> <li>• Interest payable under other long-term liabilities</li> <li>• Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount to be met from government grants and local taxpayers (premiums and discounts)</li> <li>• Interest earned and investment income</li> <li>• Amounts required in respect of the minimum revenue provision plus any additional voluntary contributions plus any other amounts for depreciation/impairment that are charged to the amount to be met from government grants and local taxpayers</li> </ul>
<b>Financial Reporting Standards (FRSs)</b>	These are standards set by governing bodies on how the financial statements should look and be presented.
<b>Investments</b>	Investments are the aggregate of:- <ul style="list-style-type: none"> <li>• Long term investments</li> <li>• Short term investments (within current assets)</li> <li>• Cash and bank balances including overdrawn balances</li> </ul> <p>From this should be subtracted any investments that are held clearly and explicitly</p>

	in the course of the provision of, and for the purposes of, operational services.
<b>IMF</b>	International Monetary Fund
<b>LOBO (Lender's Option/ Borrower's Option)</b>	Money Market instruments that have a fixed initial term (typically one to ten year) and then move to an arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan.
<b>London Inter-Bank Bid Rate (LIBID)</b>	The interest rate at which major banks in London are willing to borrow (bid for) funds from each other.
<b>Managed Funds</b>	<p><u>In-House Fund Management</u> Surplus cash arising from unused capital receipts and working cashflows can be managed either by external fund managers or by the Council's staff in-house. The in-house funds are invested in fixed deposits through the money markets for periods up to one year.</p> <p><u>Externally Management Funds</u> Fund managers appointed by the Council invest surplus cash arising from unused capital receipts in liquid instruments such as bank certificates of deposit and government stocks. The fund managers' specialist knowledge should ensure a higher rate of earnings on the managed funds than would be otherwise obtained.</p>
<b>Maturity</b>	The date when an investment is repaid or the period covered by a fixed term investment.
<b>Minimum Revenue Provision (MRP)</b>	The amount required by statute to be principal repayment each year.
<b>Monetary Policy Committee (MPC)</b>	This is a body set up by the Government in 1997 to set the repo rate (commonly referred to as being base rate). Their primary target (as set by the Government) is to keep inflation within plus or minus 1% of a central target of 2% in two year time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth

	and employment.
<b>Money Market</b>	<p>Consists of financial institutions and deals in money and credit.</p> <p>The term applied to the institutions willing to trade in financial instruments. It is not a physical creation, but an electronic/telephone one.</p>
<b>Net Borrowing</b>	For the purposes of the Code, net borrowing refers to borrowing (see above) net of investments (see above).
<b>Net Revenue Stream</b>	Estimates for net revenue stream for current and future years are the local authority's estimates of the amounts to be met from government grants and local taxpayers.
<b>Operational Boundary</b>	This is based on expectations of the maximum external debt of the authority according to probable not simply possible – events and being consistent with the maximum level of external debt projected by the estimates. It is not a limit and actual borrowing could vary around this boundary for short periods.
<b>Other Long Term Liabilities</b>	The definition of other long term liabilities is the sum of the amounts in the Council's accounts that are classified as liabilities that are for periods in excess of 12months, other than borrowing (see definition above).
<b>Premature Repayment of Loans (debt restructuring/rescheduling)</b>	A facility for loans where the Council can repay loans prior to the original maturity date. If the loan repaid has a lower interest rate than the current rate for a loan of the same maturity period the Council can secure a cash discount on the repayment of the original loan. If the loan replaced has a higher rate of interest than the current rate for a loan of the same maturity period, a cash penalty is payable to the lender.
<b>Premia</b>	Where the prevailing current interest rate is lower than the fixed rate of a long term loan, which is being repaid early, the lender can charge the borrower a premium. This is

	<p>calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.</p>
<b>Prudential Code</b>	<p>The Prudential Code is the largely self regulatory framework outlined by CIPFA for managing/monitoring capital investment in local government.</p>
<b>Public Works Loan Board (PWLB)</b>	<p>A Government agency which provides loans to local authorities. Each year, it issues a circular setting out the basis on which loans will be made available. Loans can be either at a fixed rate or on a variable rate basis. They can be repaid on either an annuity, equal instalment of principal or maturity basis. The interest rate charged is linked to the cost at which the Government itself borrows.</p>
<b>Risk</b>	<p><u>Counterparty Credit Risk</u> The risk that a counterparty defaults on its obligations.</p> <p><u>Inflation Risk</u> The risk that growth in the Authority's investment income does not keep pace with the effects of inflation on its expenditure.</p> <p><u>Interest Rate Risk</u> The risk that changes in rates of interest creates an unexpected or unbudgeted burden on the Council's finances.</p> <p><u>Liquidity Risk</u> The risk that cash will not be available when it is needed.</p> <p><u>Operational Risk</u> The risk of loss through fraud, error, corruption, system failure or other eventualities in Treasury Management dealings, and failure to maintain effective contingency management arrangements.</p> <p><u>Refinancing Risk</u></p>

	The risk that the Authority is unable to replace its maturing funding arrangements on appropriate terms.
<b>Set Aside Capital Receipts</b>	A proportion of money received by the Council for the sale of fixed assets must be set aside to repay debt.
<b>SORP</b>	Statement of Recommended Practice, published by CIPFA (Local Authority Accounting Body). This sets out guidelines regarding the Council's financial matters.
<b>Specified/Non Specified investments</b>	Specified investments are sterling denominated investments for less than 364 days as identified in Appendix C in line with statutory investment regulations. Non-specified investments are all other investments identified in Appendix C in line with statutory investment regulations.
<b>Supranational Bonds</b>	These are bonds issued by institutions such as the European Investment Bank and World Bank. As with Government bonds (Gilts) they are regarded as the safest bond investments with a high credit rating.
<b>Temporary Borrowing and Investment</b>	Loans which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days.
<b>Treasury Management</b>	Treasury Management has the same definition as in CIPFA's code of Practice of Treasury Management in the Public Services.  "The management of the organisation's 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."
<b>Yield Curve</b>	The line resulting from portraying interest rate graphically for a series of periods, e.g. 7days, 1month, 3, 6, 9, and 12months. When longer-term interest rates are higher than short-term rates the yield curve slopes upwards and is described as positive. When the opposite

	prevails the yield curve is referred to as inverse.
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### TREASURY ADVISORS' VIEW ON THE ECONOMIC BACKGROUND

#### 1.2

**UK.** UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.2%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y/y. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, more recent, round of falls in fuel prices which will now delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until 2017, though the forecasts in the Report itself were for an even slower rate of increase.

There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

**USA.** GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.1% in Q3.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong; this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**EZ.** In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, this more recent lacklustre progress, combined with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen this programme of QE by extending its time frame and / or increasing its size in order to get inflation up from the current level of around zero towards its target of 2%. The ECB will also aim to help boost the rate of growth in the EZ.

**Greece.** During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to

stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost power. A left wing / communist coalition has taken power in Portugal which is heading towards unravelling previous pro austerity reforms. This outcome could be replicated in Spain. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

**China and Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

**Emerging countries.** There are also considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

This change in investors' strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar

denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

### **CAPITA ASSET SERVICES FORWARD VIEW**

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

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

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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 economic growth turns significantly 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.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed.

rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate 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.
- 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 C

### Creditworthiness Policy and Investment Criteria

The Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads 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 suggested duration for investments. The Council will therefore use counterparties within the following durational bands

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

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	Money and/or % Limit	Time Limit
<b>Banks /UK Govt debt*</b>	<b>yellow</b>	<b>£120m</b>	<b>5yrs</b>
<b>Banks</b>	<b>purple</b>	<b>£20m</b>	<b>2 yrs</b>
<b>Banks</b>	<b>orange</b>	<b>£20m</b>	<b>1 yr</b>
<b>Banks – part nationalised</b>	<b>blue</b>	<b>£25m</b>	<b>1 yr</b>
<b>Banks</b>	<b>red</b>	<b>£20m</b>	<b>6 mths</b>
<b>Banks</b>	<b>green</b>	<b>£20m / %</b>	<b>100 days</b>
<b>Banks</b>	<b>No colour</b>	<b>Not to be used</b>	
<b>Council’s banker</b>	<b>-</b>	<b>£25m / %</b>	<b>5 yrs</b>
<b>Other institutions limit</b>	<b>-</b>	<b>£20m</b>	<b>1yr</b>
<b>DMADF</b>	<b>AAA</b>	<b>unlimited</b>	<b>6 months</b>
<b>Local authorities</b>	<b>n/a</b>	<b>£25m</b>	<b>5yrs</b>
	Fund rating	Money and/or % Limit	Time Limit
<b>Money market funds</b>	<b>AAA</b>	<b>£20m / %</b>	<b>liquid</b>
<b>Enhanced money market funds with a credit score of 1.25</b>	<b>Dark pink / AAA</b>	<b>£25m / %</b>	<b>liquid</b>
<b>Enhanced money market funds with a credit score of 1.5</b>	<b>Light pink / AAA</b>	<b>£25m / %</b>	<b>liquid</b>

*\* Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt*

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

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.

All credit ratings will be monitored before deals are undertaken and The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

## Investment Criteria for Specified and Non Specified Investments

1.1 Investments will be made in accordance with the following terms:

### 1.1.1 Specified Investments:

(All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable and the principal sum to be repaid at maturity is the same as the initial sum invested other than investments in the UK Government.)

Instrument	Minimum Credit Criteria	Use	Max investment
Debt Management Agency Deposit Facility	--	In-house	£120M
Term deposits – UK government	--	In-house	£120M
Term deposits – other LAs	--	In-house	£20M with each counterparty
Term deposits – banks and building societies	Short-term F1,P1,A1, Long-term AA- or UK nationalised banks  Blue Orange Red Green No Colour	In-house and fund managers  12 months 12 months 6 months 100 days Not for use	£20M with each counterparty/ See 2 and 3 below
Term deposits – Banks	Short-term	In-house and	£25M with each



nationalised by highly credit rated sovereign countries	F1,P1,A1, Long-term AA-  Blue Orange Red Green No Colour	fund managers  12 months 12 months 6 months 100 days Not for use	counterparty/ See 2 and 3 below
Government guarantee on all deposits by high credit rated sovereign countries	AA-	In-house and fund managers	£20M with each counterparty/ See 2 and 3 below
UK Government supported banking sector	AA-	In-house and fund managers	£20M with each counterparty/ See 2 and 3 below

### 1.1.2 **Non-Specified Investments:**

A maximum of 35% will be held in aggregate of Council managed funds in non-specified investments. A maximum of 50% of aggregate funds managed by the Council's external fund managers will be held in non-specified investments.

<b>Instrument</b>	<b>Min Credit/Colour Criteria</b>	<b>Use</b>	<b>Maximum Period</b>	<b>Maximum Investment</b>
Term deposits – UK government (with maturities in excess of 1 year)		In-house	5 years	£30M
Term deposits – other Local Authorities (with maturities in excess of 1 year)		In-house	5 years	£20M with each counterparty
Deposits with banks and building societies covered by UK government guarantee	Short-term F1,P1,A1 Long-term AA-  Blue Orange	Fund managers/ in-house	See 2 and 3 below  12 months 12 months	See 2 below/£25m with each counterparty
Certificates of deposits issued by banks and building societies covered by UK government guarantee	Short-term F1,P1,A1 Long-term AA-  Blue Orange	Fund managers/in house	See 2 and 3 below  12 months 12 months	See 2 below/£20m with each counterparty
UK Government Gilts	-	Fund Managers/in house	See 2 and 3 below/5 years	See 2 below /£20M
Treasury Bills	-	Fund Managers/in	See 2 and 3 below/5	See 2 below /£20M

		house	years	
Term deposits – banks and building societies (with maturities in excess of 1 year)	Short-term F1,P1,A1 Long-term AA-, or UK nationalised banks  Blue Orange	In-house	5 years  12 months 12 months	£20M with each counterparty
Certificates of deposits issued by banks and building societies	Short-term F1,P1,A1 Long-term AA-,  Blue Orange	fund managers/in-house	10 years  12 months 12 months	See 2 below/£20M with each counterparty
UK Government Gilts with maturities in excess of 1 year	AAA	Fund Managers/in house	10 years	See 2 below/£20M with each counterparty
Bonds issued by multilateral development banks	AAA	In-house on a 'buy-and-hold' basis.  Also for use by fund managers	5 years  10 years	£20M with each counterparty and See 2 below
Bonds issued by a financial institution which is guaranteed by the UK government	-	In-house on a 'buy-and-hold' basis.  Also for use by fund managers	5 years  10 years	£20M with each counterparty  See 2 below
Sovereign bond issues (i.e. other than the UK govt)	AAA	In- house  Fund Managers	5 years  10 years	£20M with each counterparty  See 2 below
Corporate Bonds : [under SI 1010 (W.107)]	Long-term AA-	In- house  Fund Managers	5 years  10years	£20M with each counterparty  See 2 below
Gilt Funds and Bond Funds	Long-term AA-	In- house  Fund Managers	5 years  10years	£15M  See 2 below
Money Market Funds	AAA	In- house  Fund Managers	n/a  n/a	£20M  See 2 a below
Property funds	-	Fund	n/a	£20M

		managers		See 2 below
Floating Rate Notes	Long-term AA-	Fund managers	10 years	See 2 below
Treasury Bills	N/A	Fund Managers	10 years	See 2 below
Local authority mortgage guarantee scheme	Short-term F1,P1,A1 Long-term AA-,	In-house	10 years	£20m with each counterparty

## 2. Investment Criteria – Invesco/Investec

- 2.1 The Fund will normally be invested in short term fixed interest rate deposits and certificates of deposit carrying interest rates of up to one year or debt instruments guaranteed by the UK government and also AAA rated money market funds. At any given time, a maximum of 50% of the portfolio by market value may be invested in negotiable securities carrying rates of interest for periods of over one year from the date of investment.
- 2.2 The maximum exposure to any one counter party is not to exceed 10% of the fund value or £2,000,000 whichever is the lower with the exception of money market funds where the whole balance may be invested therein. Variances to be agreed by the Head of Finance & Delivery & Delivery
- 2.3 The average duration of the investments for the fund shall not exceed 3 years, with the maximum maturity of any individual investment shall not exceed 10 years.
- 2.4 The fund will only lend to counterparties on the Invesco Standard lending list. The minimum criterion for the same is:
- Short term rating of A1, F1, P1 from the credit ratings agencies Moody's Fitch and Standard and Poor.
  - Long term rating of AA- from Standard and Poor or equivalent from Moody's or Fitch.
  - Invesco reserve the right to amend the standard lending list if internal research generated supports such a move.

N.B if there is a variation in ratings between agencies for a particular counterparty the lowest rating will be applied.

## APPENDIX D

### ***Fitch International Long-Term Credit Ratings***

International Long-Term Credit Ratings (LTCR) may also be referred to as Long-Term Ratings. When assigned to most issuers, it is used as a benchmark measure of probability of default and is formally described as an Issuer Default Rating (IDR). The major exception is within Public Finance, where IDRs will not be assigned as market convention has always focused on timeliness and does not draw analytical distinctions between issuers and their underlying obligations. When applied to issues or securities, the LTCR may be higher or lower than the issuer rating (IDR) to reflect relative differences in recovery expectations. The following rating scale applies to foreign currency and local currency ratings:

<b>Investment Grade</b>	<b>Definition</b>
AAA	Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality. 'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A	High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
BBB	Good credit quality. 'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.
<b>Speculative Grade</b>	<b>Definition</b>
BB	Speculative. 'BB' ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

B	<p>Highly speculative.</p> <ul style="list-style-type: none"> <li>• For issuers and performing obligations, 'B' ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favourable business and economic environment.</li> <li>• For individual obligations, may indicate distressed or defaulted obligations with potential for extremely high recoveries. Such obligations would possess a Recovery Rating of 'RR1' (outstanding).</li> </ul>
CCC	<p>For issuers and performing obligations, default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favourable business or economic conditions.</p> <ul style="list-style-type: none"> <li>• For individual obligations, may indicate distressed or defaulted obligations with potential for average to superior levels of recovery. Differences in credit quality may be denoted by plus/minus distinctions. Such obligations typically would possess a Recovery Rating of 'RR2' (superior), or 'RR3' (good) or 'RR4' (average).</li> </ul>
CC	<p>For issuers and performing obligations, default of some kind appears probable.</p> <ul style="list-style-type: none"> <li>• For individual obligations, may indicate distressed or defaulted obligations with a Recovery Rating of 'RR4' (average) or 'RR5' (below average).</li> </ul>
C	<ul style="list-style-type: none"> <li>• For issuers and performing obligations, default is imminent.</li> <li>• For individual obligations, may indicate distressed or defaulted obligations with potential for below-average to poor recoveries. Such obligations would possess a Recovery Rating of 'RR6' (poor).</li> </ul>
RD	<p>Indicates an entity that has failed to make due payments (within the applicable grace period) on some but not all material financial obligations, but continues to honour other classes of obligations.</p>
D	<p>Indicates an entity or sovereign that has defaulted on all of its financial obligations. Default generally is defined as one of the following:</p> <ul style="list-style-type: none"> <li>• Failure of an obligor to make timely payment of principal and/or interest under the contractual terms of any financial obligation;</li> <li>• The bankruptcy filings, administration, receivership, liquidation or other winding-up or cessation of business</li> </ul>

	of an obligor; • The distressed or other coercive exchange of an obligation, where creditors were offered securities with diminished structural or economic terms compared with the existing obligation.
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***Fitch International Short-Term Credit Ratings***

The following ratings scale applies to foreign currency and local currency ratings. A Short-term rating has a time horizon of less than 13 months for most obligations, or up to three years for US public finance, in line with industry standards, to reflect unique risk characteristics of bond, tax, and revenue anticipation notes that are commonly issued with terms up to three years. Short-term ratings thus place greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

<b>Short Term Rating</b>	<b>Current Definition</b>
F1	Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	Good credit quality. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3	Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non investment grade.
B	Speculative. Minimal capacity for timely payment of financial commitments, plus vulnerability to near term adverse changes in financial and economic conditions.
C	High default risk. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favourable business and economic environment.
D	Indicates an entity or sovereign that has defaulted on all of its financial obligations.

## APPENDIX E

### Approved Countries for Investment

#### AAA

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

#### AA+

- Finland
- U.K.
- U.S.A.

#### AA

- Abu Dhabi (UAE)
- France
- Qatar

#### AA-

- Belgium

**MINIMUM REVENUE PROVISION**

**1. Government Guidance**

The Welsh Assembly Government issued new guidance in March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council are legally obliged by section 21 (1b) to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Where the CFR was nil or negative on the last day of the preceding financial year, the authority does not need to make an MRP provision. MRP in the current financial year would therefore be zero,

**Option 1: Regulatory Method**

Under the previous MRP regulations, General Fund MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This option is available for the General Fund share of capital financing requirement which relates to capital expenditure incurred prior to 1 April 2008. It may also be used for new capital expenditure up to the amount which is deemed to be supported by the Welsh Assembly Government annual supported borrowing allocation. The use of the commutation adjustment to mitigate the MRP charge is also allowed to continue under this option.

**Option 2: Capital Financing Requirement Method**

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.



### **Option 3: Asset Life Method.**

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

The guidance suggests that any new borrowing which receives no Government support and is therefore self-financed would fall under option 3

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

Equal instalment method – equal annual instalments which are calculated using a simple formula set out in paragraph 9 of the MRP guidance,

under this approach, the MRP is provided by the following formula

$A - B$  divided by  $C$

A is the amount of capital expenditure in respect of the asset financed by borrowing or credit arrangements

B is the total provision made before the current financial year in respect of that expenditure

C is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires

Annuity method – annual payments gradually increase during the life of the asset with an appropriate interest rate used to calculate the annual amount

Asset life - the MRP guidance makes it clear that the estimated life of an asset should be determined in the year MRP commences and should not subsequently be revised

Under both options, the authority may make additional voluntary revenue provision and this may require an appropriate reduction in later years' MRP

In addition adjustments to the calculation to take account of repayment by other methods (e.g. application of capital receipts) should be made as necessary.

#### **Option 4: Depreciation Method**

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

#### **2. Date of implementation**

The previous statutory MRP requirements cease to have effect after the 2006/07 financial year. However, the same basis of 4% charge in respect of the GF share of CFR may continue to be used without limit until the 2009/10 financial year, relative to expenditure incurred up to 31/3/2008.

The guidance suggests that Options 3 and 4 should be applied to any capital expenditure which results in an increase in the CFR and does not relate to the authority's Supported Capital Expenditure.

The guidance also provides the authority with discretion to apply Options 3 or 4 to all capital expenditure whether or not supported and whenever it is incurred.

Any capitalised expenditure incurred after 1 April 2008 which gives rise to an increase in the GF CFR should be repaid by using option 3 as adapted by paragraphs 23 and 24 of the guidance.

## APPENDIX G

### Active Internal Credit UK Counterparty List (as at 15 February 2016)

Institution	Country	Bank/BS	Fitch Ratings		
			S Term	Support	L Term
Bank of Scotland	UK	Bank	F1	5	A+
Barclays	UK	Bank	F1	5	A
Close Brothers	UK	Bank	F1	5	A
Coventry Building Society	UK	BS	F1	5	A
Goldman Sachs International Bank	UK	Bank	F1		A
HSBC	UK	Bank	F1+	1	AA-
Leeds Building Society	UK	BS	F1	5	A-
Lloyds	UK	Bank	F1	5	A+
Nationwide	UK	BS	F1	5	A
Santander	UK	Bank	F1	2	A
Sumitomo Mitsui Banking Corporation	UK	Bank	F1	1	A
UBS Ltd	UK	Bank	F1	1	A
Yorkshire Building Society	UK	BS	F1	5	A-
Debt Management Office	UK				
Local Authorities	UK				