APPENDIX 4:
TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY 2014/15

PLYMOUTH
CITY COUNCIL

CABINET MINUTE 107

TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY

Malcolm Coe (Assistant Director for Finance) submitted a report setting out the Treasury Management Strategy and Prudential Indicators, including the Annual Investment Strategy as required by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in Public Services which had been considered and recommended by the Audit Committee (Audit Committee minute 50 of 23 January 2014 referred).

Councillor Lowry (Cabinet Member for Finance) introduced the proposals.

The City Council is Recommended to agree the annual Treasury Management Strategy and Annual Investment Strategy 2014/15 (incorporating the authorised limits, operational boundaries and prudential indicators) as submitted.

PLYMOUTH CITY COUNCIL

Subject:	Treasury Management Strategy and Annual Investment Strategy 2014/15
Committee:	Audit Committee / Cabinet
Date:	23 January 2014 / 11 February 2014
Cabinet Member:	Councillor Lowry
CMT Member:	Malcolm Coe (Assistant Director for Finance)
Author:	Simon Arthurs, Group Accountant
Contact details	Tel: 01752 307358 email: simon.arthurs@plymouth.gov.uk
Ref:	Fin/TM/SRA-AL-2014-01-14.
Key Decision:	No
Part:	I

Purpose of the report:

The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in Public Services requires local authorities to set a Treasury Management Strategy and Prudential Indicators on an annual basis to include the Annual Investment Strategy.

The Brilliant Co-operative Council Corporate Plan 2013/14 -2016/17:

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Treasury Management affects the Council's budget in terms of borrowing costs and investment returns. The Treasury Management Strategy sets the authorised limits and operational boundaries within which investment and borrowing decisions are taken and risks managed.

Other Implications: e.g. Child Poverty, Community Safety, Health and Safety and Risk Management:

- Risk Management to identify any risk management issues. To ensure that the councils borrowing and investments are managed with due regard to appropriate levels and categories of risk.

Equality and Diversity

Has an Equality Impact Assessment been undertaken? No

Recommendations and Reasons for recommended action:

1. Audit Committee to recommend the annual Treasury Management Strategy and Annual Investment Strategy 2014/15 (incorporating the authorised limits, operational boundaries and prudential indicators) to the Cabinet.

2. The Cabinet recommends the Treasury Management Strategy and Annual Investment Strategy 2014/15 (incorporating the authorised limits, operational boundaries and prudential indicators) to the Council for approval

Alternative options considered and rejected:

It is statutory requirement under the Local Government Act 2003 and supporting regulations to set an annual treasury strategy for borrowing and prepare an annual investment strategy. The Council has adopted the CIPFA Code of Practice for Treasury Management.

Published work / information:

Not Applicable

Background papers:

Not Applicable

Sign off:

Fin	**CDR/corpsFFC1314001/14.1.14**	Leg	LT19289.	Mon Off	19290/DVS	HR		Assets		IT		Strat Proc	
Originating SMT Member Malcolm Coe, Assistant Director													
Has the Cabinet Member(s) agreed the contents of the report? No, but this will happen following any recommendations from Audit Committee													

PLYMOUTH CITY COUNCIL

Treasury Management Strategy Statement and Annual Investment Strategy 2014/15

1. Introduction/Background

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to set a Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the CLG's Investment Guidance.

1.2 CIPFA has defined Treasury Management as:

"the management of the organisation's investments, 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."

1.3 The Council's current Treasury Management Policy Statement is set out in Appendix A. This was approved by Council on 27th February 2012. This policy remains unchanged for 2014-15 and is provided for information only. Treasury Management activity is a key factor for the Council achieving its objectives. The strategy takes into account the impact of the Council's revenue budget and capital programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators and the outlook for interest rates.

1.4 Each year, Officers work with the Council's Treasury Management advisers, currently Arlingclose, to develop a strategy that seeks to balance financial returns from the Council's cash balances whilst at the same time minimising, as far as possible, the risks associated with treasury management activity. The Council's detailed Treasury Management Strategy and Annual Investment Strategy is presented to an Audit Committee for scrutiny, prior to submission to Cabinet and Full Council for final approval.

1.5 The purpose of this Treasury Management Strategy Statement is to approve:

- Revisions to Treasury Management Strategy and Prudential Indicators for 2013/14;
- Treasury Management Strategy for 2014/15;
- Annual Investment Strategy for 2014/15 including the use of Specified and Non-Specified investments;
- Prudential Indicators for 2014/15, 2015/16 and 2016/17; and
- MRP Statement for 2014/15.

1.6 As per the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management Code at its meeting of Full Council in April 2002. The council has incorporated the changes from the revision to the CIPFA Code of Practice in 2009 and 2011 into its treasury policies, procedures and practices.

1.7 The Authority has borrowed and invested substantial sums of money and therefore has potential large exposures to financial risk including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's Treasury Management Strategy. In order to incorporate strong Governance, officers meet with key elected members, from both the main parties, on a monthly basis forming a Treasury Management Board to gain cross party support given the long term impact of some of the decisions that are taken. A "balanced scorecard" is presented to members each month to show the overall position of the Treasury Management portfolio

1.8 During the course of the year the Council will also be supporting work undertaken with other authorities and the Local Government Association to explore the creation of a Municipal Bonds Agency to provide alternative forms of borrowing. This initiative will take time to come to fruition but is an example of how authorities are working co-operatively and collaboratively.

2 External Context

2.1 **Economic background:** The Bank of England's Monetary Policy Committee (MPC) through its recent forward guidance is committed to keeping policy rates low for an extended period using the Labour Force Survey unemployment rate of 7% as a threshold for when it would consider whether or not to raise interest rates. Unemployment was 7.7% in August 2013, but is not forecast to fall below the threshold until 2016.
The flow of credit to households and businesses is slowly improving but is still below pre-crisis levels. The fall in consumer price inflation from the high of 5.2% in September 2011 to 2.7% in September 2013 will allow real wage increases (i.e. after inflation) to slowly turn positive and aid consumer spending.

Stronger growth data in 2013 (0.4% in Q1, 0.7% in Q2 and 0.8% in Q3) property prices starting to increase have led markets to price in an earlier rise in rates than predicted by the Monetary Policy Committee. However, with jobs growth picking up slowly, many employees working shorter hours than they would like and benefit cuts set to gather pace, growth is likely to be gradual. Arlingclose forecasts the MPC will maintain its resolve to keep interest rates low until the recovery is convincing and sustainable.

2.2 **Credit outlook:** The credit risk of banking failures has diminished, but not dissipated altogether. Regulatory changes are afoot in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process. This is already manifest in relation to holders of subordinated debt issued by the Co-op which will suffer a haircut on its conversion bail-in to alternative securities and/or equity There are also proposals for EU regulatory reforms to Money Market Funds which will, in all probability, result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper. Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments.

3. Treasury Management Risk

3.1 No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of the Council's treasury management activities. The CIPFA code lists risks to treasury activity as:

- Liquidity Risk (Inadequate cash resources)

- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Inflation Risk (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud)

3.2 The Council will continue to manage risks contained within its current debt and investment portfolios by establishing an integrated debt management and investment policy which balances certainty and security with liquidity and yield. The Council will continue to make use of internal borrowing and short term variable rate borrowing, whilst at the same time seeking to balance investments across a range of investment instruments. Further details of specific risks in the current borrowing and investment portfolios are outlined in the relevant sections.

3.3 Risk is managed by way of the limits set within the Prudential and Treasury Indicators which are required to be approved by Full Council before the start of each financial year.

4. Policy on the Use of Financial Instruments for the Management of Risks

4.1 Financial Instruments called derivatives are generally used to hedge risk, but can also be used for speculative purposes. Derivatives are instruments that can be bought to offset the risk of investments or debt held by the Council. They can be used to provide a hedge against interest rate risks. An example would be an interest rate swap used to exchange variable interest rates for fixed interest rates or vice versa reducing the risk of exposure to large levels of variable or fixed debt and balancing this against the mixture of variable and fixed rate investments.

4.2 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

4.3 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

4.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit.

4.5 The Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

5. The Council's Forecast Treasury Position

5.1 This report including Prudential Indicators is based on the latest available information on the Capital Programme and financing for 2013/14 to 2016/17. This is subject to approval by Cabinet on 11th February 2014. Any amendments to Prudential Indicators as a result of updates to the Capital Programme will be reported as a supplement to this report to be approved by Full Council on 24th February 2014.

5.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with the Cash Backed Internal Balances, are the core drivers of the Authority's Treasury Management activities. The movement in actual external debt and balances combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years. The forecast CFR, borrowing, balances and the resulting net borrowing requirement is set out in table 1 below.

Table 1

	2013/14 Estimate £m	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Total CFR	275.779	276.917	281.706	277.234
Less: Existing profile of borrowing Other Long Term Liabilities	229.704 42.671	175.054 41.150	175.054 39.617	175.054 38.018
Cumulative Maximum External Borrowing Requirement	**3.404**	**60.713**	**67.035**	**64.162**
Internal Balances	**45.000**	**43.000**	**41.000**	**39.000**
Cumulative Net Borrowing Requirement/(Investments)	**(41.596)**	**17.713**	**26.035**	**25.162**

5.3 The actual and estimated treasury position for 31/3/2014 and 31/3/2015 is as follows:
Table 2

	07/01/2014 Actual £m	Ave %	31/3/2014 Estimate £m	Ave %	31/3/2015 Estimate £m
External Borrowing					
Fixed Rate PWLB	44.251	5.76	44.251	5.76	54.251
Fixed Rate – Lobo	69.000	4.41	69.000	4.41	39.000
Variable Rate – Lobo	61.000	4.43	61.000	4.43	61.000
Temporary Borrowing	54.650	0.29	62.500	0.29	88.822
Fixed Rate Bonds	0.803	0.76	0.803	0.76	0.088
Sub Total External Borrowing	229.704	3.68	237.554	3.57	243.161
PFI	30.247	8.73	29.418	8.73	28.582
Finance Leases	2.189		1.953		1.717
Tamar Bridge & Torpoint Ferry	10.240		9.779		9.318

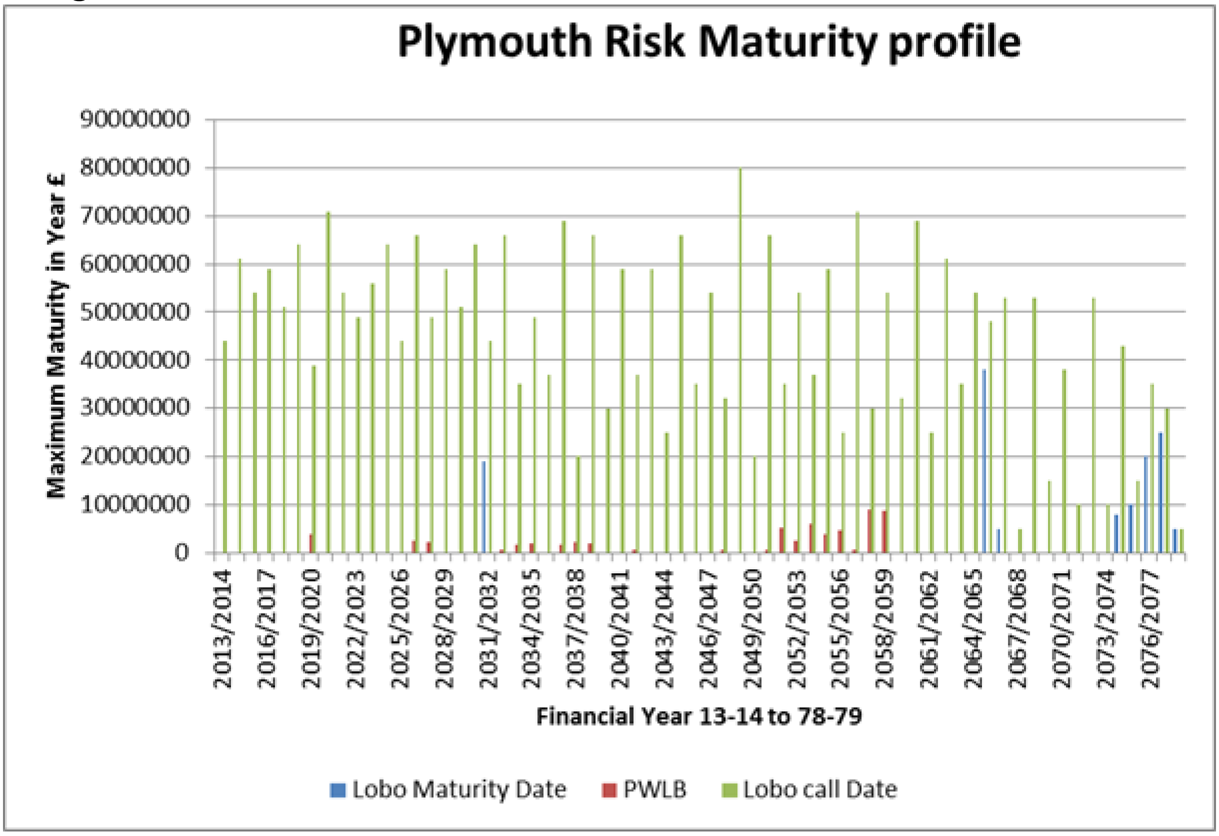
Total External Debt	**272.380**		**278.704**		**282.778**
Total Investments	**96.659**	**0.97**	**71.154**	**0.97**	**75.000**

5.4 Lobo loans are lender option borrower option loans, where the lender has the option to vary the rate at pre-agreed dates and the borrower then has the option to accept this rate or repay the loan. The option dates are set for periods ranging from 2 to 5 years. Where the period to the option date is one year or greater the loan is treated as a fixed rate. Where the period to the option date falls below one year the loan then becomes potentially subject to a change in rate in that year and therefore the loan is treated as a variable rate loan.

5.5 The Portfolio above allows for an increase in short-term borrowing and a reduction in internal borrowing due to the improvement in credit conditions. This is subject to variation based on changes in forecast cashflow, the availability of appropriate loans and variations to the borrowing requirement for the Capital Programme. Any borrowing will be maintained within the Council's Capital Financing Requirement (CFR). If credit conditions worsen the Council will revert to the use of internal funds reducing the level of both external debt and investments at 31st March 2014 and 31st March 2015.

5.6 <u>Debt Maturity</u>
The following graph shows the maturity profile of the Council's long-term external debt.

Figure 1



*The debt portfolio continues to include £130m of LOBO (market) loans. These loans have various option call dates where the banks have the ability to amend the loan terms and at which point the Council could choose to repay the loan if the terms are changed adversely. This is reflected within the maturity profile shown above (in green) to enable officers to risk manage the Council's cashflows.

5.7 The debt portfolio continues to have a higher weighting of market (LOBO) loans to PWLB. LOBO loans inherently carry a higher risk than PWLB loans as the Council cannot effectively control the repayment of such loans. This will be addressed over time with any new long term borrowing taken in PWLB loans or loans from other Local Authorities. Officers are currently reviewing the possible of early repayment of some Lobo loans in order to make revenue savings and to better balance the maturity profile of the Council's debt.

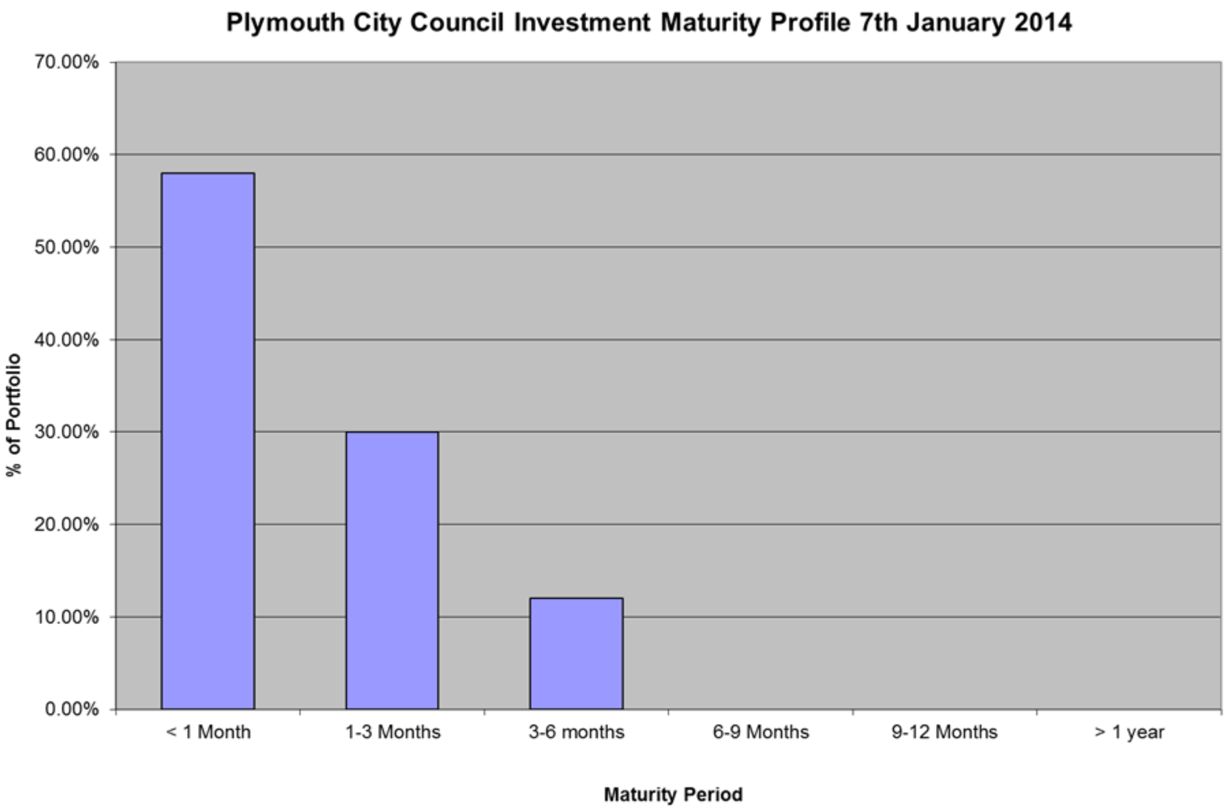
5.8 The estimate for interest payable during 2014/15, as included in the revenue budget, is £8.347m.

5.9 **Investments**

The Council's investments at 7th January 2014 were £96.659m, estimated to reduce to £79.154m at the end of the year based on forecast cashflow requirements and the continued strategy of taking short-term borrowing to meet the Council's capital expenditure financing requirement. The actual position at year end will depend on the continuation of this strategy subject to the credit conditions for the rest of the financial year and any variations in cashflow.

The graph below shows the current maturity profile of the Council's investments.

Figure 2



5.10 The Council's investments at 7th January 2014 were as follows:

Table 3

Counterparty	Total
	£m
Iceland	3.349
Lloyds Banking Group	
Bank of Scotland	5.000
Lloyds TSB	5.000
Barclays	25.975
Royal Bank of Scotland (RBS) Group	
RBS	22.310
HSBC	10.000
Svenska Handelsbanken (Swedish Bank)	10.000
Close Brothers	5.000
CCLA Lamit Property Fund	5.000
Federated Prime Rate Cash Plus Fund	1.000
Ignis Sterling Short Duration Cash Fund	1.000
Investec Short Bond Fund	1.000
Investec Target Return Fund	1.000
Payden & Rygel Sterling Reserve Fund	1.000
CCLA Public Sector Deposit Fund	0.025
Total	**96.659**

5.11 In terms of risk management, with the exception of the £3.349m still held in Iceland, the investment portfolio is now held either in UK banks or building societies, or highly rated Non-UK banks. Investments have been diversified away from purely bank deposit accounts with pooled fund investments in property, bonds and other securities taken to spread risk across a range of asset classes and enhance the return on the Council's investments. This strategy will be continued in 2014/15.

5.12 The estimate for interest receipts for 2014/15 as included in the revenue budget proposals is £0.598m.

6. *Interest Rate Forecasts*

6.1 **Interest rate forecast**: Arlingclose's forecast is for the Bank Rate to remain flat until late 2016, the risk to the upside (i.e. rates being higher) are weighted more heavily towards the end of the forecast horizon. Gilt yields are expected to rise over the forecast period with medium- and long-dated gilts expected to rise by between 0.7% and 1.1%.

6.2 A more detailed economic and interest rate forecast provided by the Authority's treasury management advisor is attached at Appendix B. The Authority will reappraise its strategy from time to time in response to evolving economic, political and financial events.

7. The Council's Borrowing Requirement and Prudential Indicators

7.1 The underlying need to borrow for capital

7.1.1 The underlying need to borrow for capital purposes is measured by reference to the Capital Financing Requirement (CFR). The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the revenue budget each year. The estimated MRP included in the 2014/15 budget is £8.394m.

7.2 Table 4 below shows the estimated CFR over the medium term.

Table 4 Prudential Indicator- CFR

Capital Financing Requirement	31/3/2013 Approved £m	31/3/2013 Revised £m	31/3/2014 Estimate £m	31/3/2015 Estimate £m	31/3/2016 Estimate £m
Total CFR	**278.983**	**275.779**	**276.917**	**281.700**	**277.234**

7.2.1 Capital expenditure not financed from internal resources, i.e. not from capital receipts, capital grants and contributions, revenue or reserves, will produce an increase in the CFR (the underlying need to borrow) and may in turn produce an increased requirement to charge MRP to the Revenue Account.

7.3 Prudential Indicator - Gross Debt and the Capital Financing Requirement

7.3.1 This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

7.3.2 If in any of these years there is a reduction in the Capital Financing Requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt.

7.3.3 The Section 151 Officer for Corporate Services reports that the Authority had no difficulty meeting this requirement in 2013/14, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

7.4 The funding of the capital programme is kept under constant review. Due to the removal of supported borrowing previously included within the settlement for capital programmes, replaced by grant, the majority of borrowing taken to cover capital expenditure is unsupported funding with the full cost of this borrowing being met from the Council's revenue budget. The estimated borrowing requirement forecast to cover the capital programme over the next 3 years based on the current monitoring positions is:

	£m
2014/15	6.322

2015/16	(2.873)
2016/17	(3.921)

7.5 The negative figures in 2015/16 and 2016/17 represent the current borrowing requirement, less the Minimum Revenue Provision (MRP) charged to revenue that used to repay debt or offset future borrowing requirements. Actual borrowing may be greater or less than the CFR but, in accordance with the Prudential Code, the Council will ensure that borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimated additional CFR for the current and next two financial years. It is currently forecast that the Council will have no borrowing in advance at 1 April 2014.

7.6 Under Section 3 of the Local Government Act 2003 and supporting regulations the Council must determine and keep under review how much it can afford to borrow. The Council is required to set two limits:

- The Authorised Limit
- The Operational Boundary

7.7 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments). The limits include any PFI or Finance Lease repayments. The limits proposed for the medium term period are shown in table 5.

Table 5 Prudential Indicator – Authorised Limit for External Debt

Authorised Limit for External Debt	**2013/14 Approved £m**	**2013/14 Revised £m**	**2014/15 Limit £m**	**2015/16 Limit £m**	**2016/17 Limit £m**
Borrowing	270	255	**295**	308	321
Other Long-term Liabilities	40	42	**40**	38	37
Total	**310**	**297**	**335**	**346**	**358**

7.8 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario, but without the additional headroom included within the Authorised Limit. Table 6 shows the Operational Boundary proposed for the medium term period.

Table 6 Prudential Indicator – Operational Boundary for External Debt

Operational Boundary for External Debt	**2013/14 Approved £m**	**2013/14 Revised £m**	**2014/15 Limit £m**	**2015/16 Limit £m**	**2016/17 Limit £m**
Borrowing	249	240	**272**	279	290
Other Long-term Liabilities	40	42	**40**	38	37
Total	**289**	**282**	**312**	**317**	**327**

7.9 The borrowing limits are required to be formally approved by Full Council and, whilst these can be amended during the year, any amendment also requires Full Council approval. The proposed Authorised Limit and Operational Boundary has been set to allow implementation, subject to due diligence, of the Councils £50m Plan for Homes which represents investment in local social housing within the city.

7.10 The Section 151 Officer has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Full Council.

7.11 The Prudential Code requires that capital expenditure remains within sustainable limits and, in particular, requires authorities to consider the impact on Council Tax. The tables below show the anticipated capital expenditure over the period to 2016/17, as outlined in the latest approved capital programme, and how this expenditure will be financed.

Table 7 Prudential Indicator – Estimates for Capital Expenditure

Capital Expenditure	**2013/14 Approved £m**	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Total	**68.922**	**57.576**	**58.716**	**34.205**	**33.465**

The capital expenditure is expected to be financed as follows:

Table 8

Capital Financing	**2013/14 Approved £m**	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Capital Receipts	6.454	**2.806**	9.589	7.086	2.026
Grants and Contributions	44.264	**40.019**	30.098	18.168	23.939
Section 106/Tariff	0.750	**1.091**	1.8130	2.000	2.000-
Revenue/Fund	2.936	**3.416**	2.500	0.750	0.500-
Total Financing	**54.404**	**47.332**	**44.000**	**28.004**	**28.465**
Borrowing:					
Supported Borrowing			-	-	-
Unsupported Borrowing	14.518	**10.244**	14.716	6.201	5.000
Total Funding	**14.518**	**10.244**	**14.716**	**6.201**	**5.000**
Total Financing and Funding	**68.922**	**57.576**	**58.716**	**34.205**	**33.465**

7.12 Incremental Impact of Capital Investment Decisions

As an indicator of affordability the table below shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Table 9 Prudential Indicator – Incremental Impact of Capital Investment Decisions

Incremental Impact of Capital Investment Decisions	**2013/14 Approved**	**2013/14 Revised**	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**

	£m	£m	£m	£m	£m
Increase in Band D Council Tax	1.17	0.83	**2.52**	3.60	11.00

7.13 The impact on the Council Tax in 2014/15 and future years reflect the cumulative cost of financing the approved capital programme in 2014/15 to 2016/17.

7.14 Ratio of Financing Costs to Net Revenue Stream

The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on the costs net of investment income.

Table 10 Prudential Indicator – Ratio of Financing Costs to Net Revenue Stream

Ratio of Financing Costs to Net Revenue Stream	2013/14 Approved %	2013/14 Revised %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
	7.78	7.26	**7.83**	8.47	8.99

8 The Borrowing Strategy for 2013

8.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast provided in Appendix B indicates that an acute difference between short and longer term interest rates is expected to continue. This difference creates a "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments because of the gap between what is paid on the borrowing and what is earned on the investment. The cost of carry is likely to be an issue until 2016 and beyond. As borrowing is often for longer dated periods (anything up to 50 years), the cost of carry needs to be considered against a backdrop of uncertainty and affordability constraints in the Authority's wider financial position. Whilst the strategy is to diversify the overall portfolio, the prevailing market rate predictions and the rates of historical investment and borrowing mean it makes good economic sense to seek opportunities to repay and restructure debt where this is affordable and to spread maturity profiles.

8.2 The Authority's current level of debt and investments is set out at Table 1 and Table 2 in section 4 of this report.

8.3 As indicated in Table 1 in Section 4 of this report, the Authority has a forecast gross borrowing requirement of £60.713m in 2014/15. The Council has insufficient set aside revenue balances to cover this debt requirement so at some point during 2014/15 additional borrowing will be required. The recent strategy has been to borrow short-term funding from other Local Authorities up to the Capital Financing Requirement (CFR) allowing internal balances to be externally invested. Subject to credit conditions this strategy will be continued in 2014/15 mixed with taking some longer term to spread the debt maturity profile within the overall portfolio. Should credit conditions adversely change, internal borrowing will be used to reduce counterparty and credit risk. By essentially lending its own surplus funds to itself, the Authority is able to reduce overall treasury risk by reducing the level of its external investment balances. The Council will adopt a flexible approach to borrowing in consultation with its treasury management advisers, Arlingclose. The following issues will be considered prior to undertaking any external borrowing.

- Affordability
- Credit and Counterparty risk of increased investments
- Maturity profile of existing debt
- Interest rate and refinancing risk
- Borrowing Source

8.4 Borrowing options available to the Council are:

- Internal
- Public Works Loan Board (PWLB)
- Local authorities
- European Investment Bank Commercial banks
- Capital markets (stock issues, commercial paper and bills)
- Structured finance
- Leasing

8.5 The cost of carry has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Authority's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. Over the medium term Officers will look to adjust the maturity profile of the Councils debt and some longer term debt will be reviewed to achieve this.

8.6 The Authority has £130m exposure to LOBO loans (Lender's Option Borrower's Option) of which £61m of these can be "called" within 2014/15. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Authority since the decision to call a LOBO is entirely at the lender's discretion.

Any LOBOs called will be discussed with the treasury advisers prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted.

Furthermore, some LOBO's represent debt maturing or likely to mature, in the longer term due to the terms and also the prevailing market rate predictions. Opportunities to repay LOBO's and spread the debt maturity profile will be considered, again taking advice from our treasury advisors and where it makes economic sense over the whole portfolio to do so.

8.7 **Debt rescheduling**

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace loans with new loans or repay without replacement.

The rationale for undertaking any debt rescheduling would be one or more of the following:

- Reduce investment balance and credit exposure via debt repayment
- Align long-term cash flow projections and debt levels
- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

As opportunities arise, they will be discussed with the Council's treasury advisers and the Councils Treasury Management Board.

8.8 Any rescheduling activity will be reported to the Cabinet in monitoring reports, reflected in the budget impact of the relevant revenue budget reporting, the Treasury Management Board at monthly meetings and formal treasury management mid-year and annual reports will also be presented to Audit Committee and Full Council.

8.9 The following Treasury Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

Table 11 Treasury Indicator – Upper Limits for Interest Rate Exposure

	2013/14 Approved %	**2013/143 Revised** %	**2014/15 Limit** %	**2015/16 Limit** %	**2016/17 Limit** %
Upper Limit for Fixed Interest Rate Exposure	200	210	**210**	210	210
Upper Limit for Variable Interest Rate Exposure	50	60	**60**	60	60

8.10 The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt.

Table 12 Treasury Indicator – Maturity Structure of Fixed Rate Borrowing

Maturity structure of fixed rate borrowing	Approved Upper limit for 2013/14 %	Upper Limit for 2014/15 %	Lower Limit for 2014/15 %
under 12 months	40	**40**	**0**
12 months and within 24 months	60	**60**	**0**
24 months and within 5 years	40	**60**	**0**
5 years and within 10 years	25	**50**	**0**
10 years and within 20 years	25	**50**	**0**
20 years and within 30 years	25	**30**	**0**
30 years and within 40 years	30	**20**	**0**
40 years and within 50 years	35	**20**	**0**
50 years and above	25	**20**	**0**

These limits are based on the risk of Lobo loans being called and repaid at the next option date and not at the final maturity date.

ANNUAL INVESTMENT STRATEGY 2014-15

9 Investment Strategy

9.1 In accordance with investment guidance issued by the CLG and best practice this Authority's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yields earned on investments is important but are secondary considerations.

9.2 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the CLG.

Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the Authority and are not deemed capital expenditure investments under statute. Non-specified investments are, effectively, everything else.

9.3 The types of investments that will be used by the Authority and whether they are specified or non-specified are as follows:

Table 13 Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Investments with Registered Providers	✓	✓

Certificates of deposit with banks and building societies (CD's)	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	×
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	×
Commercial Paper	✓	×
Corporate Bonds	✓	✓
AAA rated Money Market Funds	✓	×
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	×
Loans to other organisations	✓	✓

9.4 The credit rating limits proposed for specified investments with institutions for 14-15 is a lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's of A-. Limits will be set for levels depending on the rating of each institution.

9.5 In response to the forthcoming changes in bank regulations and the proposal to further diversify the Council's investments within the criteria set out above new specified and non-specified investments will be made/considered within the following limits:

Counterparty	Minimum Security / Credit Rating	Maximum Amount	Maximum Period
UK Government	Government Backed	No limit	12 Months
UK Local Authorities	High Security	£10m each	12 Months
UK Banks and other organisations and securities	Lowest published long-term credit rating from Fitch , Moody's and Standard & Poor's A-	£20m each	12 Months
Non UK Banks and other organisations and securities	Lowest published long-term credit rating from Fitch , Moody's and Standard & Poor's A-	£10m each	12 Months
UK Registered Providers of Social Housing	Lowest published long-term credit rating from Fitch , Moody's and Standard & Poor's A-	£5m each	12 Months
Bonds issued by multilateral development banks	AAA or Government Guaranteed	£20m each	12 Months
Money market funds		Max £5m per fund limited to 0.5% of net asset value of MMF 2% of net asset value	Call

		for Government MMF's	
Other MMF's and Collective Investment Schemes	Pooled funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments	£20m	No set maturity date

The following sets out limits for investments that fall within the category of non-specified Investments. These investments are required to be identified separately to ensure the Council understands these are higher risk, either due to counterparty risk, liquidity risk and/or interest rate risk. The Council has traditionally invested in term deposits or call accounts, although the annual strategy statements have outlined a number of other specified and non-specified instruments. Non-specified investments available to be used in 2014/15 are detailed below.

Investment	Minimum Security / Credit Rating	Maximum Amount	Maximum Period
UK Government	Government Backed	No Limit	50 years**
UK Local Authorities	High Security	£5m each	25 years**
UK Banks and other organisations and securities	Lowest published long-term credit rating from Fitch , Moody's and Standard & Poor's		
	AAA	£5m each	10 years*
	AA+	£5m each	5 years*
	AA	£5m each	4 years*
	AA-	£5m each	3 years*
	A+	£5m each	2 years
Non UK Banks and other organisations and securities	Lowest published long-term credit rating from Fitch , Moody's and Standard & Poor's		
	AAA	£5m each	10 years*
	AA+	£5m each	5 years*
	AA	£5m each	4 years*
	AA-	£5m each	3 years*
	A+	£5m each	2 years
UK Registered Providers of Social Housing	Lowest published long-term credit rating from Fitch , Moody's and Standard & Poor's BBB- and those without ratings	£5m each	5 years
Bonds issued by multilateral development banks	AAA or Government Guaranteed	£20m total	10 years
UK Building Societies without ratings	Subject to credit assessment	£1m each	1 Year
Other MMF's and Collective Investment Schemes	Pooled funds which meet the definition of a Collective Investment	£20m total	No set maturity date

	Scheme per SI 2004 No 534 and subsequent amendments		
Any other organisation	Subject to an external credit assessment and specific advice from the Authority's treasury management advisers.	£2m each £1m each £100k each	3 Months 1 year 5 years

* but no longer than 2 years in fixed-term deposits and other illiquid instruments.

** but no longer than 5 years in fixed-term deposits and other illiquid instruments.

9.6 The authority will have a maximum of 50% of its total investments in unspecified investments. There will be limit of 10% of total investments in any one non-UK country

There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented.

In addition, the Authority may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Authority's treasury management adviser.

9.7 **Registered Providers**: Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain a high likelihood of receiving government support if needed. The Authority will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

9.8 **Building Societies**: The Authority takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Authority's deposits would be paid out in preference to retail depositors. The Authority will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

9.9 **Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Authority. Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. The requirement for AAA ratings has been removed following EU proposals to stop money market funds from having credit ratings.

9.10 **Other Pooled Funds:** The Authority will have cash balances available for investment over the medium term. It will therefore continue to use pooled bond, and property funds, and consider equity funds, that offer enhanced returns over the longer term, but are potentially more volatile in the shorter term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

9.11 **Other Organisations:** The Authority may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Authority's treasury management adviser.

9.12 **Credit risk Prudential Indicator**

9.13 The Council considers security, liquidity and yield, in that order, when making investment decisions.

9.14 Credit ratings remain an important element of assessing risk but they are not a sole feature in the Council's assessment of credit risk.

9.15 The Council also considers alternative assessments of credit strength and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings for financial institution (minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms/potential support from well resourced parent institutions;
- Credit Default Swaps (where quoted);
- Share prices (where available);
- Economic fundamentals (for example Net Debt as a percentage of GDP);
- Macro-economic indicators;
- Corporate developments, news, articles, market sentiment and momentum;
- Subjective overlay.

9.16 The only indicators with prescriptive values remain credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

9.17 With this is in mind Arlingclose have developed the following matrix to score the credit risk of an authority's investment portfolio:

- Value weighted average credit risk score
- Value weighted average credit rating score

- Time weighted average credit risk score
- Time weighted average credit rating score

<u>Scoring methodology:</u>

- Value weighted average reflects the credit quality of investments according to the size of the deposit
- Time weighted average reflects the credit quality of investments according to the maturity of the deposit
- Credit quality is calculated as:
  -AAA = highest credit quality = 1
  - D = lowest credit quality = 15

The Council will aim for A- or higher credit rating, with a score of 7 or lower, to reflect an investment approach with its main focus on security within the proposed use of counterparties and investment limits set in this report.

9.18 Any institution can be suspended or removed should any of the factors identified above give rise to concern.

It remains the Authority's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. What this means is that an institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

9.19 **Authority's Banker** – The Authority currently banks with the Co-operative Bank. This contact expires on 31st March 2014. Following a competitive tender Barclays Bank PLC has been selected as the Councils bankers commencing 1st April 2014. Barclays current lowest published long-term credit rating is A, Should the banks rating fall below the minimum criteria Barclays Bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

9.20 The Council's in-house investments are made with reference to the outlook for the UK Bank Rate and money market rates. The current counterparty list and investment strategy permits the Council to invest in:

- The Debt Management Agency Deposit Facility (DMO)
- Treasury Bills (T-Bills) issued by the UK Government
- Term deposits or business reserve accounts with UK banks or building societies
- UK nationalised/part nationalised banks
- Deposits with other local authorities
- Deposits with highly credit rated foreign banks, on the advice of Arlingclose
- Certificate of deposits with banks and building societies
- Bonds issued by multilateral development banks
- Gilts (Bonds issued by the UK government)
- UK Government Treasury Bills (T-Bills)
- Commercial Paper
- Corporate Bonds

- Money Market Funds (MMF) with a Constant Net Asset Value (Constant NAV investing predominantly in government securities)
- Money Market Funds with a Constant Net Asset Value (Constant NAV) investing in instruments issued primarily by financial institutions
- Money Market Funds with a Variable Net Asset Value (VNAV)
- Other Money Market Funds and Collective Investment Schemes which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and Si 2007 No 573
- Registered Providers

In addition to these available investments, new investment types proposed for 2014-15 to give greater flexibility within the risks identified in this report are:

- Investments with any other organisation subject to an external assessment and specific advice from the authority's treasury management advisers.

9.21 The Council needs to maintain flexibility in its investment options if it is to be able to respond quickly to changing circumstances, and the above list continues to outline a number of investment instruments available for use in the coming year. The inclusion of such instruments on the list will afford the Section 151 Officer, acting under delegated authority in accordance with the Constitution and in consultation with the Strategic Treasury Management Board, the flexibility required to manage the investment portfolio on a day to day basis responding to market conditions without the need to seek prior Council approval for changes. Inclusion of an instrument on the list does not mean that the Council will necessarily make use of these during the year. New organisations and instruments would not be used without careful monitoring of the credit risk and liaison with our treasury advisers.

9.22 In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office (DMADF) and UK Treasury Bills. The rates of interest from the DMADF/T-Bills are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

9.23 The Council and its treasury advisers, Arlingclose, will continue to analyse and monitor the indicators set and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

9.24 The Council will keep a minimum of £15m in liquid investments at all times to ensure cash is available to meet its liabilities.

9.25 The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2014/15. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.

9.26 To protect against a lower for longer prolonged period of low interest rates and/or to provide certainty of income some longer-term investment options, set out below, may be considered during 2014/15 following the advice of our treasury advisers, Arlingclose.

- Longer-term deposits/CD's with Banks and Building Societies. Any deposits will be based on credit conditions and the rates available, with priority given to the security of funds.

- UK Government Gilts. Rates on offer have fallen sharply over the past year but these investments provide the highest level of security and may be considered if credit conditions worsen.
- Deposits with Local Authorities. These rates are lower than those available from Banks and Building Societies but provide additional security and may be used to secure investment returns.
- Supranational Bonds (bonds issued by multilateral development banks):- even at the lower yields likely to be in force, the return on these bonds would provide certainty of income against an outlook of low official interest rates.
- Pooled Funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments. These are investment products where the Council would purchase units and receive a dividend payment. The capital growth of these investments varies over time and would only be considered as long-term investments. Such funds include Property, Bonds and Equities. Due to fluctuations in the capital value with these type of investments there is a risk on disinvestment that the Council may not receive the full value of the original investment at the time the investment is withdrawn.
- Registered providers – These investments are likely to attract very competitive interest rates, with the Council in effect replacing banks as providers of short-term and long-term funding. Further investigation would be required to assess the security of this sector before any investment is made.

9.27 The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. No more than 30% of the Council's investment portfolio will be in investments exceeding 364 days at any one time.

Table 13 Prudential (Treasury) Indicator – upper limit for sums invested more than 364days

Upper Limit for total principal sums invested over 364 days	2013/14 Approved £m	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
	30	30	40	40	40

9.28 Within these limits the Section 151 Officer will maintain a lending list of Counterparties. Limits in place for each investment type and counterparty will depend on the economic circumstances and the credit risk. The list will continue to be reviewed and updated by the Section 151 Officer during the year.

9.29 The target rate of return on new investment in 2014/15 is 0.80%. The investment interest included in the 2014/15 budget is £0.598m.

9.30 The benchmark to be used for the Council's investment returns will be the daily average 7- day London Interbank Bid rate (LIBID).

10. Investments defined as Capital Expenditure

10.1 The acquisition of share capital or loan capital in any body corporate, a loan or grant or financial assistance by the Council to another body for capital expenditure, and certain other types of investment are defined as capital expenditure under the relevant regulations.

10.2 The Council's will consider loans to Registered Providers (Housing Associations) and other organisations within Plymouth that will be defined as capital expenditure.

11. Balanced Budget Requirement

11.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget. The proposed budget for 2014/15 is set out in the 2014/15 budget report.

12. Annual MRP Statement

12.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

12.2 The four MRP options available are:

Option 1: Regulatory Method – this method replicates the position that would have existed under the previous regulatory environment. MRP is charged at 4% of the Authority's underlying need to borrow for capital purposes; the Capital Financing Requirement (CFR). The formula includes an item known as "Adjustment A" which was intended to achieve neutrality between the CFR and the former Credit Ceiling which was used to calculate the MRP prior to the introduction of the Prudential System on 1st April 2004.

Option 2: CFR Method – This method simplifies the calculation of MRP by basing the charge solely on the Authority's CFR but excludes the technical adjustments in Option 1, resulting in a higher charge using this method. The annual MRP is set at 4% of the non-housing CFR at the end of the preceding financial year.

Option 3: Asset Life Method – Under this method MRP is determined by the life of the asset for which the borrowing is undertaken. This can be calculated as follows:

1. MRP commences in the financial year following that in which the expenditure is incurred or in the year following that in which the relevant asset becomes operational. This enables an MRP "holiday" to be taken in relation to assets which take more than one year to be completed before they become operational.
2. The estimated life of the asset will be determined in the year that MRP commences and will not be subsequently revised. However additional repayments can be made in any year which will reduce the level of payments in subsequent years.

3. If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life on the land will be treated as equal to the structure, where this would exceed 50 years.

Option 4: Depreciation Method – The depreciation method is similar to that under option 3 but MRP is equal to the depreciation provision required in accordance with proper accounting practice to be charged to the Income and Expenditure account.

12.3 MRP in 2014/15: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self-financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).

12.4 Under the regulations, the authority is required before the start of each financial year to prepare a statement of its policy on making MRP in respect of that financial year and submit it to the Full Council. The proposed policy for 2014/15 is as follows:

Supported Borrowing
For borrowing supported by Revenue Support Grant the Council will continue to use the regulatory method (Option 1).

Unsupported Borrowing
For new borrowing under the prudential system for which no Government support is being given and is therefore self-financed, MRP will be made in equal annual instalments over the life of the asset (Option 3).

Capitalisation Directions
For capitalisation directions on expenditure incurred since 1 April 2008 MRP will be made in equal annual instalments over 20 years in line with DCLG guidance (Option 3).

PFI/Leases
MRP in respect of PFI and leases brought on the Balance Sheet under the 2009 SORP and IFRS will match the annual principal repayment for the associated deferred liability.

MRP will be charged on the Tamar Bridge and Torpoint Ferries Joint Committee's outstanding unfinanced assets included in the Council's Capital Financing requirement. This will be offset by an equivalent receipt from the Joint Committee.

Any loan or investment to an organisation defined as capital expenditure will not attract MRP. The original capital expenditure will be met from the capital receipt on the maturity of the loan/investment.

MRP will commence in the financial year following the one in which the expenditure is incurred, except for expenditure funded by unsupported borrowing where the project is not complete at 31st March 2015 (classified as under construction). MRP will be deferred until the construction is complete and operational with the charge to be made in the year following completion.

13. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

13.1 In accordance with the recommendations of the Treasury Management Code, the Council's Audit Committee will be responsible for the scrutiny of treasury management activities and practices.

13.2 The Section 151 Officer will report to the Audit Committee and Full Council on treasury management activity and performance at least twice a year against the strategy approved for the year (being a mid-year review and an end of year review).

13.3 The Council is required to produce an outturn report on its treasury activity no later than 30th September after the financial year end.

14. Other Items

14.1 <u>Training</u>

CIPFA's Code of Practice requires the Section 151 Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

Members of the Audit Committee received training in Treasury Management in December 2013. Council Officers will organise additional training for members and staff with Arlingclose and any other suitable organisation to ensure relevant needs are met.

14.2 <u>Investment Consultants</u>

The CLG's Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investments and
- How the quality of service is controlled

The Authority uses Arlingclose as treasury management advisers and receives the following services:

- Credit advice
- Investment advice
- Technical advice
- Economic & interest rate forecasts
- Workshops and training events

The authority maintains the quality of service through quarterly review meetings and periodically tendering for the provision of Treasury Management consultancy services.

TREASURY MANAGEMENT POLICY STATEMENT

1. INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Cabinet and the Audit Committee and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

"The management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

Appendix B

Economic & Interest Rate Forecast (Sections 5.1 & 7.1)

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	1.00
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk													
3-month LIBID rate													
Upside risk	0.20	0.25	0.30	0.35	0.40	0.50	0.55	0.60	0.65	0.70	0.75	0.90	0.95
Arlingclose Central Case	0.45	0.45	0.50	0.55	0.65	0.75	0.75	0.75	0.75	0.75	0.80	0.80	0.80
Downside risk			0.05	0.10	0.20	0.30	0.30	0.30	0.30	0.30	-0.35	-0.35	-0.35
1-yr LIBID rate													
Upside risk	0.35	0.30	0.35	0.40	0.45	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.80
Arlingclose Central Case	0.90	0.95	0.95	0.95	1.00	1.05	1.10	1.15	1.20	1.25	1.30	1.40	1.40
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt yield													
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	1.45	1.50	1.55	1.60	1.65	1.70	1.75	1.85	1.95	2.10	2.30	2.50	2.50
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80
10-yr gilt yield													
Upside risk	0.50	0.50	0.50	0.65	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	3.00	3.10	3.30	3.50	3.50
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80
20-yr gilt yield													
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.25	3.30	3.35	3.40	3.45	3.50	3.55	3.65	3.75	3.85	4.05	4.15	4.15
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80
50-yr gilt yield													
Upside risk	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.45	3.50	3.55	3.60	3.65	3.70	3.75	3.80	3.85	3.95	4.05	4.15	4.15
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80

Underlying assumptions:

- Growth continues to strengthen with the second estimate for Q3 growth coming in at an unrevised 0.8%. The service sector remains the main driver of growth, boosted by a contribution from construction.
- The unemployment rate has fallen to 7.6%. The pace of decline in this measure will be dependent on a slower expansion of the workforce than the acceleration in the economy, alongside the extent of productivity.
- The CPI for November has fallen to 2.1%, a much more comfortable position for the MPC. Utility price increases are expected to keep CPI above the 2% target in 2014, before falling back again.
- The principal measure in the MPC's Forward Guidance on interest rates is the Labour Force Survey (LFS) unemployment rate. The MPC intends not to raise the Bank Rate from its current level of 0.5% at least until this rate has fallen to a threshold of 7%.
- The reduction in uncertainty and easing of credit conditions have begun to unlock demand, much of which has fed through to the housing market. In response to concerns over a house price bubble, the Bank of England announced a curtailment of the Funding for Lending Scheme, which will henceforth concentrate on business lending only.

- The MPC will not hesitate to use macro prudential and regulatory tools to deal with emerging risks (such as curtailing the FLS). Absent risks to either price stability or financial stability, the MPC will only tighten policy when it is convinced about the sustained durability of economic growth.
- Federal Reserve monetary policy expectations - the slowing in the pace of asset purchases ('tapering') and the end of further asset purchases - will remain predominant drivers of the financial markets. Tapering of asset purchases will begin in Q1 2014. The US political deadlock over the debt ceiling will need resolving in Q1 2014.
- The European backstop mechanisms have lowered the risks of catastrophic meltdown. The slightly more stable economic environment at the aggregate Eurozone level could be undone by political risks and uncertainty in Italy, Spain and Portugal (doubts over longevity of their coalitions). The ECB has discussed a third LTRO, as credit conditions remain challenging for European banks.
- China data has seen an improvement, easing markets fears. Chinese leaders have signalled possible monetary policy tightening.

On-going regulatory reform and a focus on bail-in debt restructuring of is likely to prolong banking sector deleveraging and maintain the corporate credit bottleneck