PLYMOUTH CITY COUNCIL

Subject:	Treasury Management Strategy and Annual Investment Strategy 2015/16
Committee:	Cabinet
Date:	10 February 2015
Cabinet Member:	Councillor Lowry
CMT Member:	Malcolm Coe (Assistant Director for Finance)
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Ref:	Fin/ZW
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 Statement 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. 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.

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

A robust Treasury Management Strategy is key to ensuring a successful delivery of our Medium Term Financial Plan and ensuring the Council can achieve its objectives to be a Pioneering, Growing Caring and Confident City.

Equality and Diversity

Has an Equality Impact Assessment been undertaken?

Yes, attached as background paper. No impacts identified.

Recommendations and Reasons for recommended action:

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

   This is to comply with the CIPFA Code of Practice and discharge our statutory requirement.

2. Cabinet recommends the mid-year review of the 2014/15 Treasury Management Strategy to the Council for noting, as recommended by the Audit Committee.

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:

Title	Part I	Part II	Exemption Paragraph Number						
			1	2	3	4	5	6	7
Equality Impact Assessment	x								

Sign off:

Fin	mc1415.36	Leg	lt22201/300115	Mon Off	MO/22201	HR		Assets		IT		Strat Proc	
Originating SMT Member Malcolm Coe, Assistant Director													
Has the Cabinet Member(s) agreed the contents of the report? Yes													

Treasury Management Strategy Statement 2015/16 and Annual Investment Strategy 2015/16

1. Introduction

1.1 In accordance with the Council's Constitution and CIPFA code, it is a requirement that the Treasury Management Strategy and Annual Investment Strategy is presented to the Audit Committee. On 18 December 2014 the Audit Committee agreed to delegate authority to approve the Treasury Management Strategy and Annual Investment Strategy 2015/16 to the Head of Corporate Strategy in consultation with the Chair and Vice Chair of the Audit Committee. A meeting was held on 28 January 2015 and the Head of Corporate Strategy and the Chair and Vice Chair agreed to recommend the Treasury Management and Annual Investment Strategy 2015/16 to Cabinet for approval.

1.2 In April 2002 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

1.3 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.

1.4 In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

1.5 This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

1.6 The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

2. External Context

2.1 <u>Economic background</u>

There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for an 0.25% increase in rates at each of the meetings between August and December 2014, the minutes of the January 2015 meeting showed unanimity in maintaining the Bank Rate at 0.5% as there was sufficient risk that low inflation could become entrenched and the MPC became more concerned about the economic outlook.

2.2 Credit outlook

The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The *Bank Recovery and Resolution Directive* promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast *Deposit Guarantee Schemes Directive* includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, **the credit risk associated with making unsecured bank deposits will increase** relative to the risk of other investment options available to the Authority.

2.3 Interest rate forecast

The Authority's treasury management advisor Arlingclose forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year. Arlingclose projects gilt yields on an upward path in the medium term, taking the forecast average 10 year PWLB loan rate for 2015/16 to 2.7%.

A more detailed economic and interest rate forecast provided by the Arlingclose is attached at ***Appendix B***.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1%, and that new long-term loans will be borrowed at an average rate of 0.8%.

3. Local Context – The Authority's forecast treasury position

3.1 The Authority currently has £290m of borrowing and £100m of investments. This is set out in further detail at ***Appendix B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.14 Actual £m	31.3.15 Estimate £m	31.3.16 Estimate £m	31.3.17 Estimate £m	31.3.18 Estimate £m
General Fund CFR	264.75	256.55	247.68	248.24	241.88
Less: Other debt liabilities *	-40.27	-40.27	-39.62	-38.02	-36.42
Borrowing CFR	**224.49**	**216.28**	**208.06**	**210.22**	**205.46**
Less: External borrowing **	-229.70	-249.45	-245.45	-245.41	-245.41
Internal (over) borrowing	**-5.22**	**-33.17**	**-37.39**	**-35.18**	**-39.94**
Less: Working capital/Usable Reserves	45.00	43.00	41.00	39.00	38.00
Investments (or New borrowing)	**39.78**	**9.83**	**3.61**	**3.82**	**1.94**

* *finance leases and PFI liabilities that form part of the Authority's debt*
** *shows only loans to which the Authority is committed and excludes optional refinancing*

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, subject to holding a minimum investment balance.

3.3 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 above.

4. Borrowing Strategy

4.1 The Authority currently holds £144 million of loans, a decrease of £30 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £4m in 2015/16. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

4.2 Objectives

The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

4.3 Strategy

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2015/16 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Authority may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

4.4 Sources

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) or its equivalent in 2015/16
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds other than the Devon Local Government Pension Fund.
- capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Authority has previously raised some of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

4.5 LGA Bond Agency

Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the Authority and used to bolster the Agency's capital strength instead. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

4.6 LOBOs

The Authority holds £100m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £44m of these LOBOS have options during 2015/16, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £100m.

4.7 Short-term and Variable Rate loans

These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

4.8 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. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5. Investment Strategy

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £83.3 and £107.2 million, and similar levels are expected to be maintained in the forthcoming year.

5.2 Objectives

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

5.3 Strategy

Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2015/16. This is especially the case for the estimated £40m that is available for longer-term investment. The majority of the Authorities surplus cash is currently invested in short-term unsecured bank deposits. This diversification will therefore represent a substantial change in strategy over the coming year.

5.4 Approved Counterparties

The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	**Banks Unsecured**	**Banks Secured**	**Government**	**Corporates**	**Registered Providers**
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£6m 5 years	£12m 20 years	£20m 50 years	£6m 20 years	£6m 20 years
AA+	£6m 5 years	£12m 10 years	£12m 25 years	£6m 10 years	£6m 10 years
AA	£6m 4 years	£12m 5 years	£12m 15 years	£6m 5 years	£6m 10 years
AA-	£5m 3 years	£12m 4 years	£12m 10 years	£6m 4 years	£6m 10 years
A+	£5m 2 years	£12m 3 years	£6m 5 years	£6m 3 years	£6m 5 years
A	£4m 13 months	£5m 2 years	£6m 5 years	£6m 2 years	£6m 5 years
A-	4m 6 months	£5m 13 months	£6m 5 years	£6m 13 months	£6m 5 years
BBB+	£3m 100 days	£5m 6 months	£2m 2 years	£2m 6 months	£2m 2 years
BBB or BBB-	£0m next day only	£5m 100 days	n/a	n/a	n/a
None			£12m 5 years		£3m 5 years
Pooled funds	£25m per fund				

This table must be read in conjunction with the notes below

5.5 Credit Rating

Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

5.6 Banks Unsecured

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank Barclays Bank plc.

5.7 Banks Secured

Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

5.8 Government

Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

5.9 Corporates

Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

5.10 Registered Providers

Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed.

5.11 Pooled Funds

Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market 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 pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short 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.

5.12 Risk Assessment and Credit Ratings

Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.13 Other Information on the Security of Investments

The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

5.14 Specified Investments

5.15 The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of [A-] or higher.

5.16 Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£45m
Total investments without credit ratings or rated below A-	£25m
Total investments with institutions domiciled in foreign countries rated below AA+	£0m
Total non-specified investments	£70m

5.17 Investment Limits

The Authority's revenue reserves available to cover investment losses are forecast to be £60 million on 31st March 2015. In order that no more than 30% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £20 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below:

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£12m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker's nominee account	£40m per broker
Foreign countries	£12m per country
Registered Providers	£12m in total
Unsecured investments with Building Societies	£10m in total
Loans to unrated corporates	£5m in total
Money Market Funds	£20m in total

5.18 Liquidity Management

The Authority uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

6. Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.1 Security

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target
Portfolio average credit A+	A

6.2 Liquidity

The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target
Total cash available within 3 months	£15m

6.3 Interest Rate Exposures

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2015/16	**2016/17**	**2017/18**
Upper limit on fixed interest rate exposure	210%	210%	210%
Upper limit on variable interest rate exposure	60%	60%	60%

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

6.4 Maturity Structure of Borrowing

This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.5 Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2015/16	2016/17	2017/18
Limit on principal invested beyond year end	£45m	£40m	£40m

7. Other Items

7.1 There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

7.2 Policy on Use of Financial Derivatives

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 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, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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 and the relevant foreign country limit.

7.3 Investment Training

The needs of the Authority's treasury management staff for training in investment management are assessed every three months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

7.4 Investment Advisers

The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by quarterly review meetings and periodically tendering for the provision of Treasury Management consultancy services.

7.5 Investment of Money Borrowed in Advance of Need

The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £295 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

8. Financial Implications

The budget for investment income in 2015/16 is £0.7 million, based on an average investment portfolio of £100 million at an interest rate of 0.73%. The budget for debt interest paid in 2015/16 is £7.2 million, based on an average debt portfolio of £249 million at an average interest rate of 3.41%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

9. Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 Officer, having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Appendix A – Treasury Management Policy Statement

INTRODUCTION AND BACKGROUND

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

POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

- 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."
- 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.

- 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.

- 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.

- 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 – Arlingclose Economic & Interest Rate Forecast October 2014

Underlying assumptions:

- The UK economic recovery has continued. Household consumption remains a significant driver, but there are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP throughout this year.

- We expect consumption growth to slow, given softening housing market activity, the muted outlook for wage growth and slower employment growth. The subdued global environment suggests there is little prospect of significant contribution from external demand.

- Inflationary pressure is currently low and is likely to remain so in the short-term. Despite a correction in the appreciation of sterling against the US dollar, imported inflation remains limited. We expect commodity prices will remain subdued given the weak outlook for global growth.

- The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.

- Nominal earnings growth remains weak and below inflation, despite large falls in unemployment, which poses a dilemma for the MPC. Our view is that spare capacity remains extensive. The levels of part-time, self-employment and underemployment are significant and indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.

- However, we also expect employment growth to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure.

- In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone. These factors will maintain the dovish stance of the MPC in the medium term.

- The continuing repair of public and private sector balance sheets leave them sensitive to higher interest rates. The MPC clearly believes the appropriate level for Bank Rate for the post-crisis UK economy is significantly lower than the previous norm. We would suggest this is between 2.5 and 3.5%.

- While the ECB is likely to introduce outright QE, fears for the Eurozone are likely to maintain a safe haven bid for UK government debt, keeping gilt yields artificially low in the short term.

- The probability of potential upside risks crystallising have waned a little over the past two months. The primary upside risk is a swifter recovery in the Eurozone.

Forecast:

- Arlingclose continues to forecast the first rise in official interest rates in Q3 2015; general market sentiment is now close to this forecast. There is momentum in the economy, but inflationary pressure is benign and external risks have increased, reducing the likelihood of immediate monetary tightening.

- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited; we believe the normalised level of Bank Rate post-crisis to range between 2.5% and 3.5%.

- The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. We project gilt yields on an upward path in the medium term.

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**	**1.75**	**1.75**
Downside risk				0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
3-month LIBID rate													
Upside risk	0.05	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	**0.55**	**0.60**	**0.65**	**0.85**	**1.00**	**1.15**	**1.30**	**1.45**	**1.60**	**1.75**	**1.85**	**2.05**	**2.15**
Downside risk	0.10	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	-0.95	-0.95	-0.95	-1.00
1-yr LIBID rate													
Upside risk	0.10	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	**0.95**	**1.00**	**1.05**	**1.20**	**1.35**	**1.50**	**1.65**	**1.80**	**1.95**	**2.10**	**2.20**	**2.40**	**2.50**
Downside risk	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80	-0.80
5-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	**1.70**	**1.75**	**1.90**	**2.00**	**2.10**	**2.20**	**2.30**	**2.40**	**2.50**	**2.60**	**2.70**	**2.90**	**2.95**
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.60	-0.65	-0.70	-0.70	-0.70
10-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	**2.40**	**2.45**	**2.55**	**2.60**	**2.65**	**2.70**	**2.75**	**2.80**	**2.85**	**2.90**	**2.95**	**3.05**	**3.10**
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60
20-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	**2.90**	**2.95**	**3.05**	**3.10**	**3.15**	**3.20**	**3.25**	**3.30**	**3.35**	**3.40**	**3.45**	**3.50**	**3.55**
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.50	-0.55	-0.55	-0.60	-0.60	-0.60
50-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	**3.00**	**3.05**	**3.10**	**3.15**	**3.20**	**3.25**	**3.30**	**3.35**	**3.40**	**3.45**	**3.50**	**3.55**	**3.60**
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60

Appendix C – Existing Investment & Debt Portfolio Position

	31/12/2014 Actual Portfolio £m	31/12/2014 Average Rate %
External Borrowing:		
PWLB – Fixed Rate	44.252	5.7625
PWLB – Variable Rate	0.000	0.000
Local Authorities	105.200	0.4113
LOBO Loans	100.000	4.3813
Total External Borrowing	**249.452**	**3.4146**
Other Long Term Liabilities:		
PFI	29.440	8.73
Finance Leases	1.937	n/a
Cornwall County Council (TBTF)	8.889	n/a
Total Gross External Debt	**289.718**	
Investments:		
Managed in-house		
Short-term investments	67.372	0.7300
Long-term investments	18.025	Variable
Managed externally		
Fund Managers		
Pooled Funds	15.000	Variable
Total Investments	**(100.397)**	
Net Debt	**189.321**	

Appendix D - Prudential Indicators 2015/16

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure:

The Authority's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
General Fund	56.67	48.71	13.05	10.56
Total Expenditure	**56.67**	**48.71**	**13.05**	**10.56**
Capital Receipts	14.32	4.44	2.07	0.61
Government Grants	28.66	30.19	10.04	6.56
Reserves	0.42	0.03	-	-
Revenue	1.19	0.53	-	-
Borrowing	10.08	13.52	0.94	3.39
Leasing and PFI	-	-	-	-
Total Financing	**56.67**	**48.71**	**13.05**	**10.56**

Estimates of Capital Financing Requirement:

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.15 Revised £m	31.03.16 Estimate £m	31.03.17 Estimate £m	31.03.18 Estimate £m
Total CFR	**256.55**	**247.68**	**248.24**	**241.88**

The CFR is forecast to fall by £15m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement:

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

Debt	**31.03.15 Revised £m**	**31.03.16 Estimate £m**	**31.03.17 Estimate £m**	**31.03.18 Estimate £m**
Borrowing	249.45	245.51	245.51	245.51
Finance leases	1.94	1.72	1.48	1.24
PFI liabilities	38.33	37.90	36.54	35.17
Total Debt	**289.72**	**285.13**	**283.52**	**281.92**

Total debt is expected to remain below the CFR during the forecast period until March 2018.

Operational Boundary for External Debt:

The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

Operational Boundary	**2014/15 Revised £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**
Borrowing	249.55	274.51	274.51	274.51
Other long-term liabilities	40.27	39.62	38.02	36.42
Total Debt	**289.82**	**314.13**	**312.53**	**310.93**

Authorised Limit for External Debt:

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	**2014/15 Revised £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**
Borrowing	268.97	295.87	325.45	358.00
Other long-term liabilities	40.27	39.62	38.02	36.42
Total Debt	**309.24**	**335.49**	**363.47**	**394.42**

Ratio of Financing Costs to Net Revenue Stream:

This 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 financing costs, net of investment income. We have set a maximum limit of 10% and forecast to stay within this limit through the period under review.

Ratio of Financing Costs to Net Revenue Stream	**2014/15 Revised %**	**2015/16 Estimate %**	**2016/17 Estimate %**	**2017/18 Estimate %**
General Fund	8.2	8.7	9.1	9.3

Incremental Impact of Capital Investment Decisions:

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	**2015/16 Estimate £**	**2016/17 Estimate £**	**2017/18 Estimate £**
General Fund - increase in annual band D Council Tax	**3.6**	11.0	17.0

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in April 2002.

Appendix E – Annual Minimum Revenue Provision Statement 2015/16

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.

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 2015/16: 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 2015/16 is as follows:

<u>Unsupported Borrowing</u>
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).

<u>Capitalisation Directions</u>
For capitalisation directions on expenditure incurred since 1 April 2008 MRP will be made in equal annual instalments over the asset life.

<u>PFI/Leases</u>
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.

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 2016 (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.

No MRP will be charged in respect of assets held within the Housing Revenue Account.

Capital expenditure incurred during 2015/16 will not be subject to a MRP charge until 2016/17.

Based on the Authority's latest estimate of its Capital Financing Requirement on 31st March 2015, the budget for MRP has been set as £9.074m.

APPENDIX F

PLYMOUTH CITY COUNCIL

Subject:	Treasury Management Strategy 2014/15 – Mid Year Review
Committee:	Audit Committee
Date:	18 December 2014
Cabinet Member:	Councillor Mark Lowry
CMT Member:	Malcolm Coe (Assistant Director for Finance)
Author:	Zoe Wilkinson, Lead Accountant
Contact details	Tel: 01752 304707 email: zoe.wilkinson@plymouth.gov.uk
Ref:	ACCT/DJN
Key Decision:	No
Part:	I

Purpose of the report:

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Council's strategy for 2014/15 was approved by full Council at its budget meeting on 23 January 2014. This report provides an update on the progress and outcomes against the Treasury Management Strategy for the six month period ended 30 September 2014. It is a requirement of the CIPFA Code of Practice on Treasury Management that a full mid-year report, as a minimum, should be presented to Full Council.

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 and its implications have been fully incorporated into the council's budgets.

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

Equality and Diversity

Has an Equality Impact Assessment been undertaken? No

Recommendations and Reasons for recommended action:

1. The report be noted by the Audit Committee and presented to Full Council.
   As required by Cipfa Code of Practice, Treasury Management
2. The Audit Committee agree that approval of the Treasury Management Strategy and Annual Investment Strategy 2015/16 is delegated to the Head of Corporate Strategy in consultation with the Chair and Vice Chair of the Audit Committee to agree a final version before being submitted to Full Council for authorisation in February 2015.

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 which requires a mid-year report to be submitted to the Audit Committee and Full Council covering the performance against this approved strategy.

Published work / information:

Treasury Management Strategy report to Council 23 January 2014
Treasury Management Practices update for 2014-15 report to Audit Committee 26 June 2014

Background papers:

Title	Part I	Part II	Exemption Paragraph Number						
			1	2	3	4	5	6	7
Not applicable									

Sign off:

Fin	djn14 15.24	Leg	alt/219 04	Mon Off		HR		Assets		IT		Strat Proc	
Originating SMT Member - Malcolm Coe													
Has the Cabinet Member(s) agreed the contents of the report? Yes													

Treasury Management Strategy Mid-Year Review

1. Introduction

1.1 The definition of Treasury Management is:

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

1.2 The responsibility for implementing and monitoring Treasury Management policies and practices and for the execution and administration of Treasury Management decisions is delegated by the Council to its Section 151 Officer and is overseen by a Treasury Management Board consisting of Councillors and senior officers of the Council.

1.3 The day to day operation of the Treasury Management activity is carried out in accordance with detailed Treasury Management Practices (TMP's). Updates to these practices for 2014-15 were approved by the Audit Committee on 26th June 2014.

1.4 The Council works closely with its Treasury Management advisers, Arlingclose, who assist the Council in formulating views on interest rates, regular updates on economic conditions and interest rate expectations, and advise on specific borrowing and investment decisions.

1.5 Under the Council's approved Strategy we continue to manage risk and diversify our investment portfolio.

2. Review of the Council's Performance April – September 2014

2.1 Table 1 shows the Council's overall treasury portfolio at 30th September 2014 compared to the position at the start of the year.

Table 1

01/04/2014 £m	Average Interest rate %		30/9/2014 £m	Average Interest rate %
		External Borrowing Long-term:		
44.252	5.79	PWLB	44.252	5.76
100.000	4.38	Market	100.000	4.38
0.087	0.65	Bonds	0.036	0.60
80.800	0.29	Temporary Borrowing	85.500	0.29
225.139	**3.19**	**Total PCC Borrowing**	**229.788**	**3.12**
		Long-term liabilities		
29.440	8.73	PFI Schemes	29.440	8.73
1.937	n/a	Finance Leases	1.937	n/a
8.889	n/a	Cornwall County Council (TBTF)	8.889	n/a
265.405		**Total External Debt**	**270.054**	
(70.812)	0.89	Bank Deposits	82.222	0.83
(7.500**)**	Variable	Property Fund (Pooled investment)	10.000	Variable
(5.025)	Variable	Other External Funds	15.025	Variable
(83.337)		**Total Investments**	**(107.247)**	
182.068		**Net Borrowing/(Net Investment) Position**	**162.807**	

3. Borrowing

3.1 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:

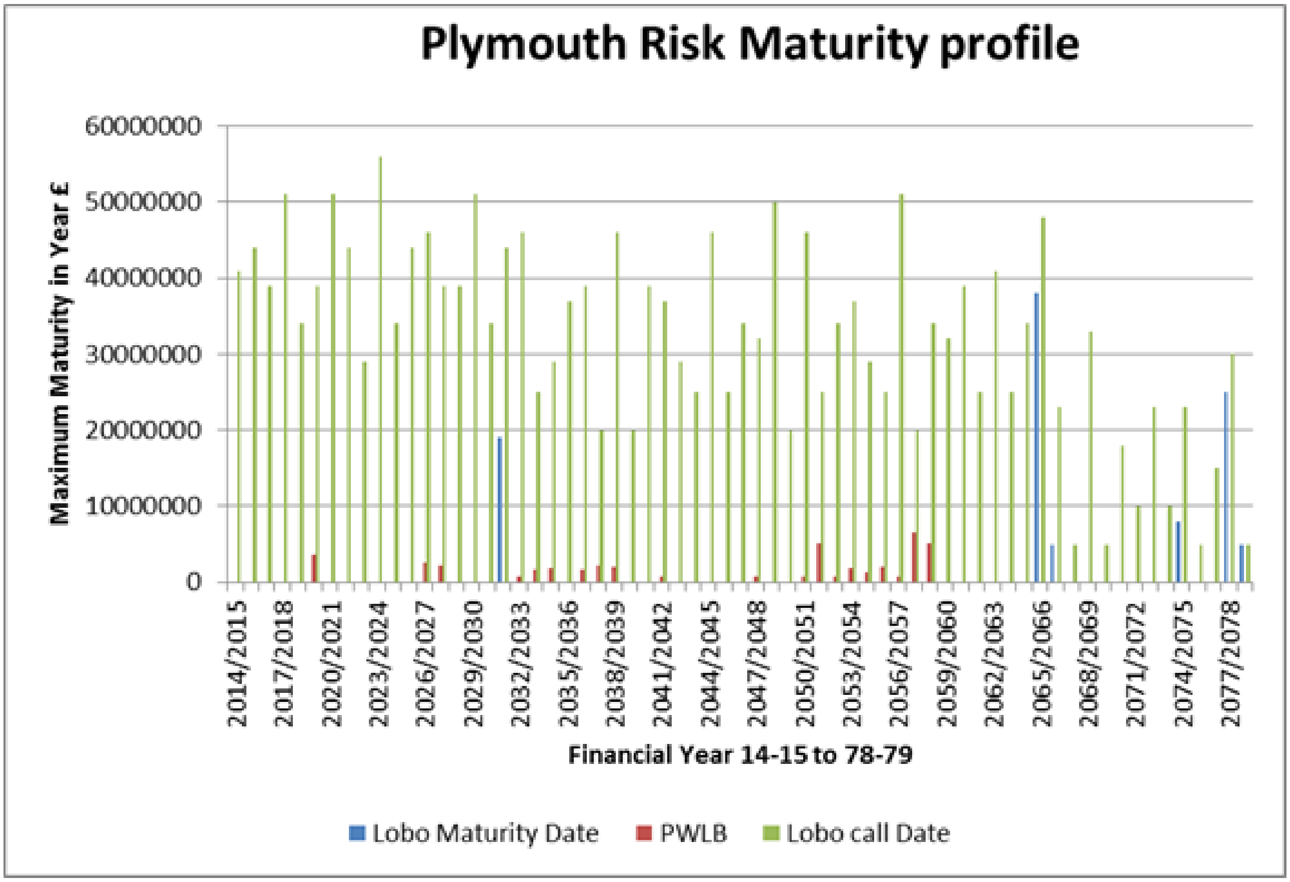
3.2 The external debt limits for 2014/15, as approved by Council in January 2014, are as follows:

- Authorised limits £335m
- Operational Boundary £312m

3.3 These limits have not been breached in the period 1st April to 30th September 2014.

3.4 The following graph in ***Figure 1*** shows the maturity profile of the Council's £144.242m borrowing at 30th September 2014:

Figure 1



3.5 The debt portfolio currently includes £100m of LOBO 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. This is reflected within the maturity profile shown above (in green) to enable officers to risk manage the Council's cash flows

3.6 Table 2 shows the movement in the borrowing portfolio during the year.

Table 2

	Balance 01/04/2014 £000s	Debt Maturing £000s	Debt Repaid £000s	New Borrowing £000s	Balance 30/09/14 £000s	Increase / (Decrease) in Borrowing
Short Term Borrowing	80,800	0	0	4,700	85,500	4,700
Long Term Borrowing	144,339	(51)	0	0	144,288	(51)
TOTAL BORROWING	**225,139**	**(51)**	**0**	**4,700**	**229,788**	**4,649**

3.7 New borrowing in year

The use of short-term borrowing has continued to be the most cost effective means of financing capital expenditure and cashflow requirements. During the first half of the year the level of borrowing was constrained within a maximum investment level to generate additional revenue savings whilst maintaining the risk of excessive level of investments. By matching any short-term borrowing with the available liquid deposits held in bank call accounts, this has lowered overall treasury risk by allowing flexibility of reducing debt and investment levels at short notice should credit conditions deteriorated.

The Council started the year with £80.8m of short–term loans. New loans were taken out in the period 1st April to 30th September 2014 with an average period of 70 days at an average rate of 0.29%.

3.8 Debt Rescheduling

There has been no debt rescheduling in the period. Officers along with our advisers Arlingclose continue to monitor PWLB interest rates looking for opportunities to repay any debt, maximising the savings achieved whilst maintaining a balanced maturity profile.

3.9 Overall debt performance for the first part of the year

All new debt taken in 2014-15 has been in short-term borrowing to meet cash flow/capital financing requirements. Over the period total loan debt has increased by £4.649m as a result of an increase in short-term borrowing.

Due to affordability and credit risk the current borrowing strategy is to take short-term borrowing at very low rates. However the Section 151 officer will continue to monitor interest rates and credit conditions and consider long-term borrowing in line with the approved 2014/15 Treasury Management Strategy.

4. Investments

4.1 Managing Investment Risk

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 (accessibility) of the Authority's investments is important but is a secondary consideration.

4.2 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.

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

Table 3 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	✓	✓

4.4 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.

4.5 Investment Activity

Investments are made short term to cover cash flow and liquidity requirements and longer term to maximise and guarantee future income.

With bank deposit rates falling and current returns not being as attractive, the Authority continues to look at alternative investment products to diversify its portfolio. After discussions with Arlingclose, the Council's Treasury Management Advisers, a number of fund managers were interviewed and the following funds chosen:

- Federated Prime Rate Cash Plus Fund
- Ignis Sterling Short Duration Cash Fund
- Investec Short Bond Fund
- Investec Target Return Fund
- Payden & Rygel Sterling Reserve Fund

£1-2m has been deposited in each of these funds investing in a range of investments and asset classes including Certificates of Deposits (CD) and Government and Corporate Bonds. The target return on these funds will produce around 1%. The performance of these funds will be included in the Treasury Management out-turn report.

4.6 Table 4 and Figure 2 below show the split of investments over country/sector as at 30th September 2014.

Figure 2:

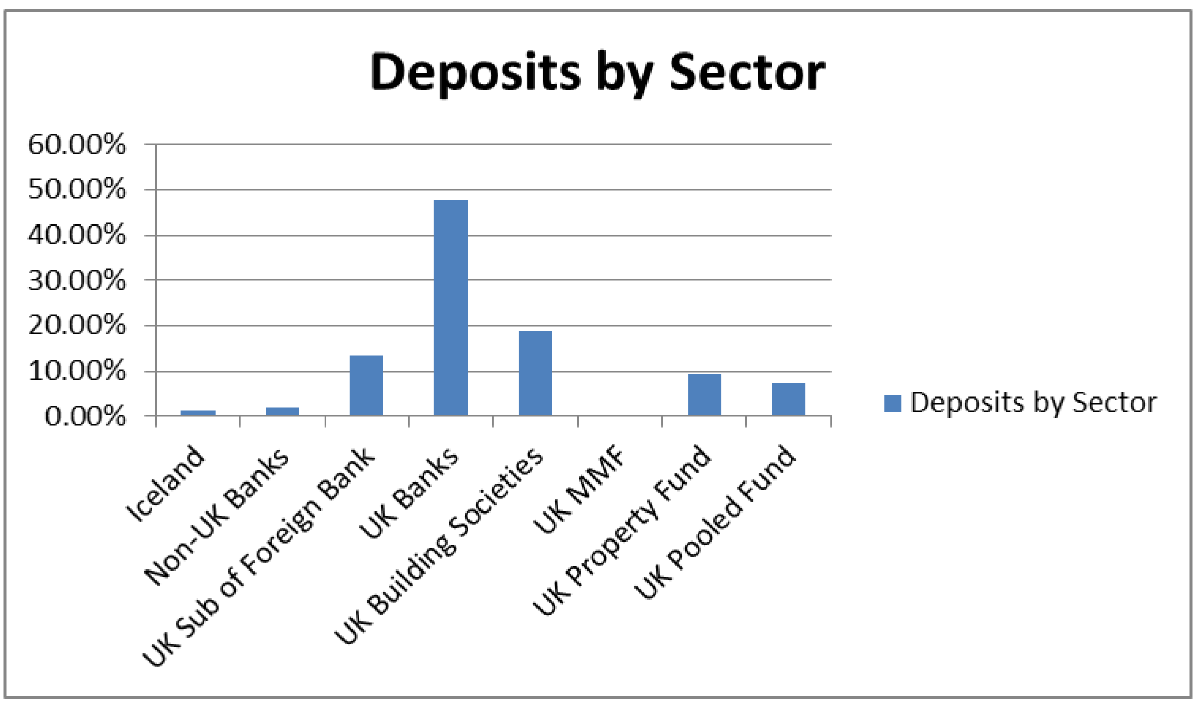
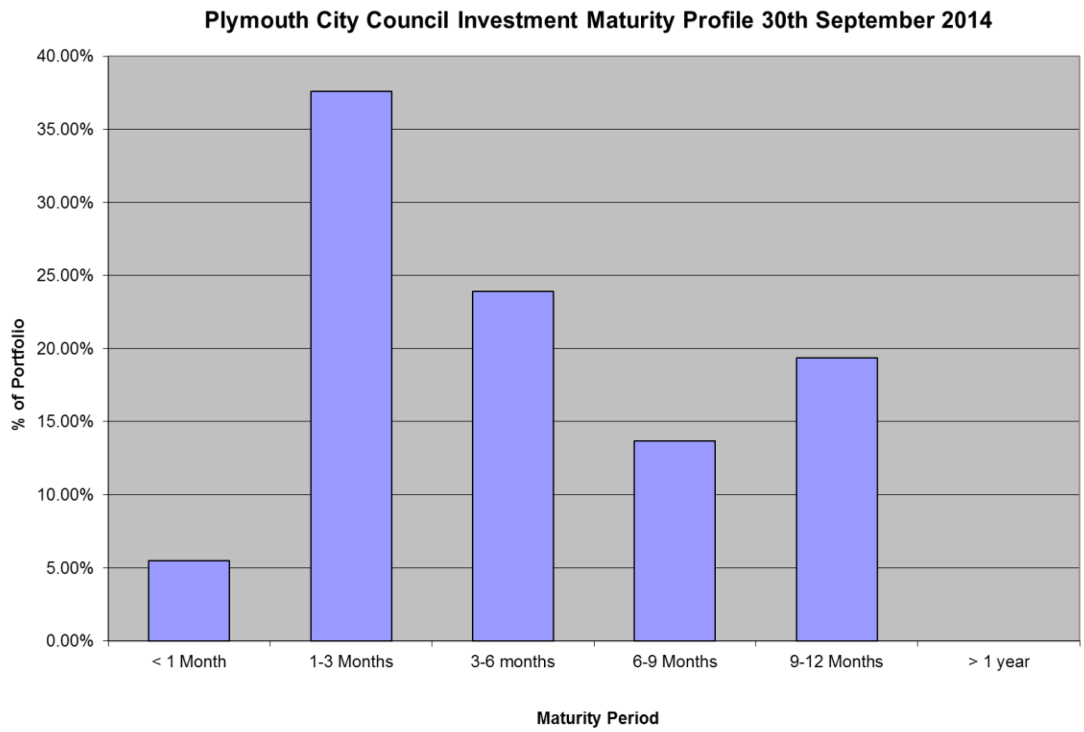


Table 4

Counterparty	Total £m	Sector Type	%	Sector %
Santander UK (was Abbey National)	14.500	UK Subsidiary of Foreign Bank	13.52	13.52
Lloyds Banking Group	15.000	UK Banks	13.99	
Barclays	13.285	UK Banks	12.39	
HSBC	15.000	UK Banks	13.99	
Close Brothers	5.000	UK Banks	4.66	
Standard Chartered	3.000	UK Banks	2.80	47.83
Nationwide Building Society	16.000	UK Building Societies	14.92	
National Counties Building Society	1.000	UK Building Societies	0.93	
Market Harborough Building Society	1.000	UK Building Societies	0.93	
Furness Building Society	1.000	UK Building Societies	0.93	
Cumberland Building Society	1.000	UK Building Societies	0.93	18.64
Nordea Bank Finland	1.000	Non UK Banks	0.93	
Rabobank	1.000	Non UK Banks	0.93	1.86
CCLA Lamit Property Fund	10.000	UK Property Fund	9.32	9.32
Iceland	1.437	Iceland	1.34	1.34
UK MMF	0.025	UK MMF	0.02	0.02
Federated Prime Rate Cash Plus Fund	2.000	UK Pooled Fund	1.87	
Ignis Sterling Short Duration Cash Fund	2.000	UK Pooled Fund	1.87	
Investec Short Bond Fund	2.000	UK Pooled Fund	1.87	
Investec Target Return Fund	1.000	UK Pooled Fund	0.93	
Payden & Rygel Sterling Reserve Fund	1.000	UK Pooled Fund	0.93	7.47
Total	**107.247**		**100.00**	**100.00**

4.7 The maturity profile of the Council's deposits is represented in figure 3. This shows a large proportion of deposits maturing during the 1 – 3 month period, reflecting the deposits in call accounts. These types of deposits ensure that the Council has the ability to react quickly to adverse changes in market conditions.

Figure 3



4.8 Credit Risk

The Treasury Management Strategy report to Audit Committee in February 2010 outlined a recommendation that officers work to develop a set of benchmarking criteria against which the Council's investment risk could be measured. This continues to be used in 2014-15:

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

4.9 Table 3 shows the rating currently attached to the Council's portfolio and its movement during the year.

Table 3

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2014	5.32	A+	5.73	A
30/06/2014	5.38	A+	5.68	A
30/09/2014	5.67	A	4.84	A

Throughout the first half of the year the Council's credit score was maintained well within the target level of 7 as set in the approved 2014/15 strategy.

4.10 Arlingclose have used the scoring matrix to compare Plymouth's investment risk against other unitary authorities who use Arlingclose as their advisers. The results are shown in section 5.

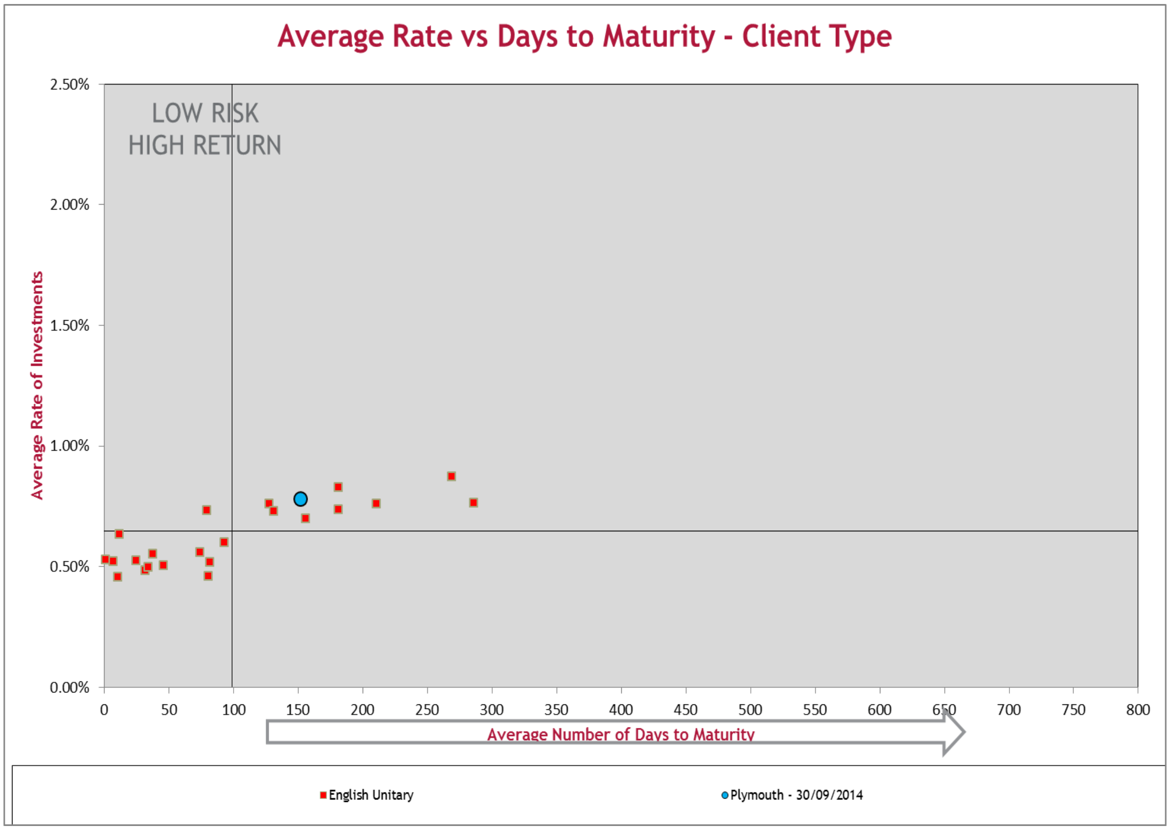
5. Benchmarking

5.1 The Council's performance on investments is measured against a benchmark of the 7 day libid rate. For the period to 30th September 2014 the return on investments made in 2014/15 was 0.83% against the average 7 day Libid for the period of 0.347%.

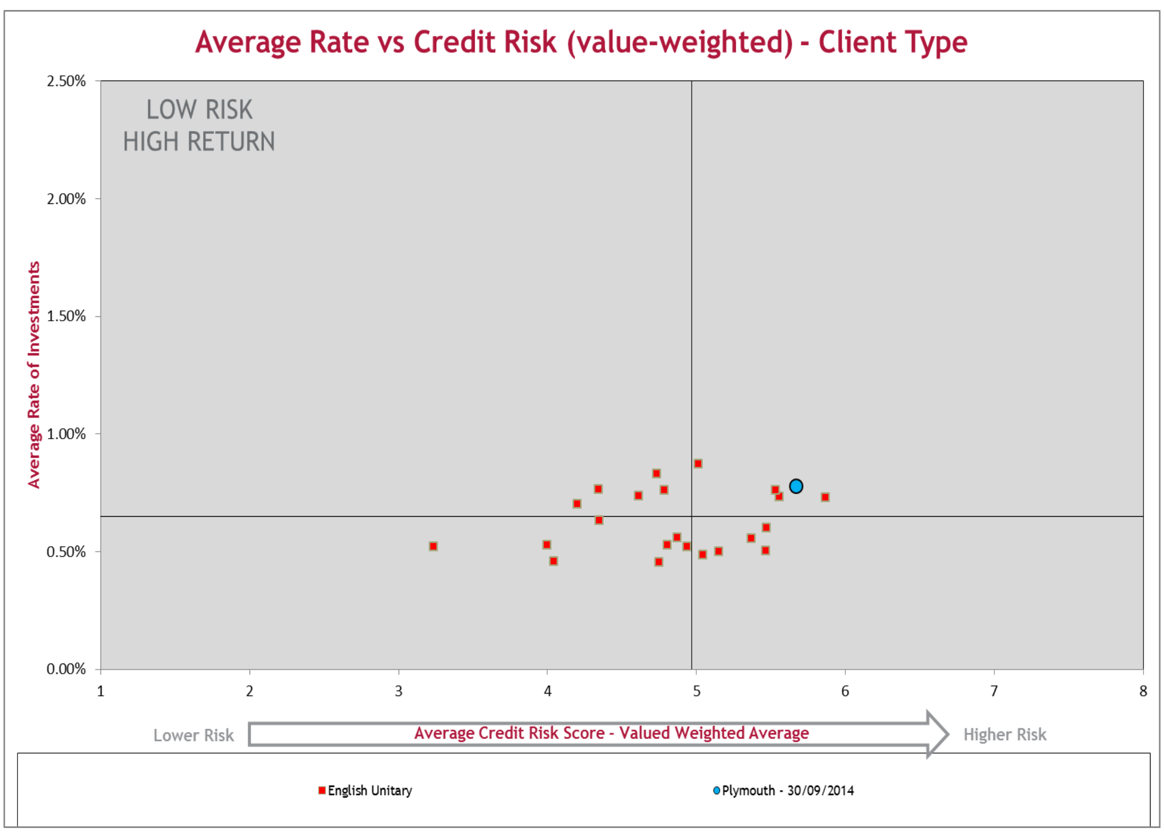
5.2 As outlined above, Arlingclose have developed a set of benchmarking criteria to enable comparisons on performance to be made on data provided by all their clients. To compare like with like the following graphs compare our performance with other unitary authorities. We feel that the best graphs used to demonstrate our performance to 30th September 2014 are as follows;

1. Average rate of investment against average maturity period
2. Average rate of investment against value weighted average credit risk score
3. Average rate of investment against time weighted average credit risk score

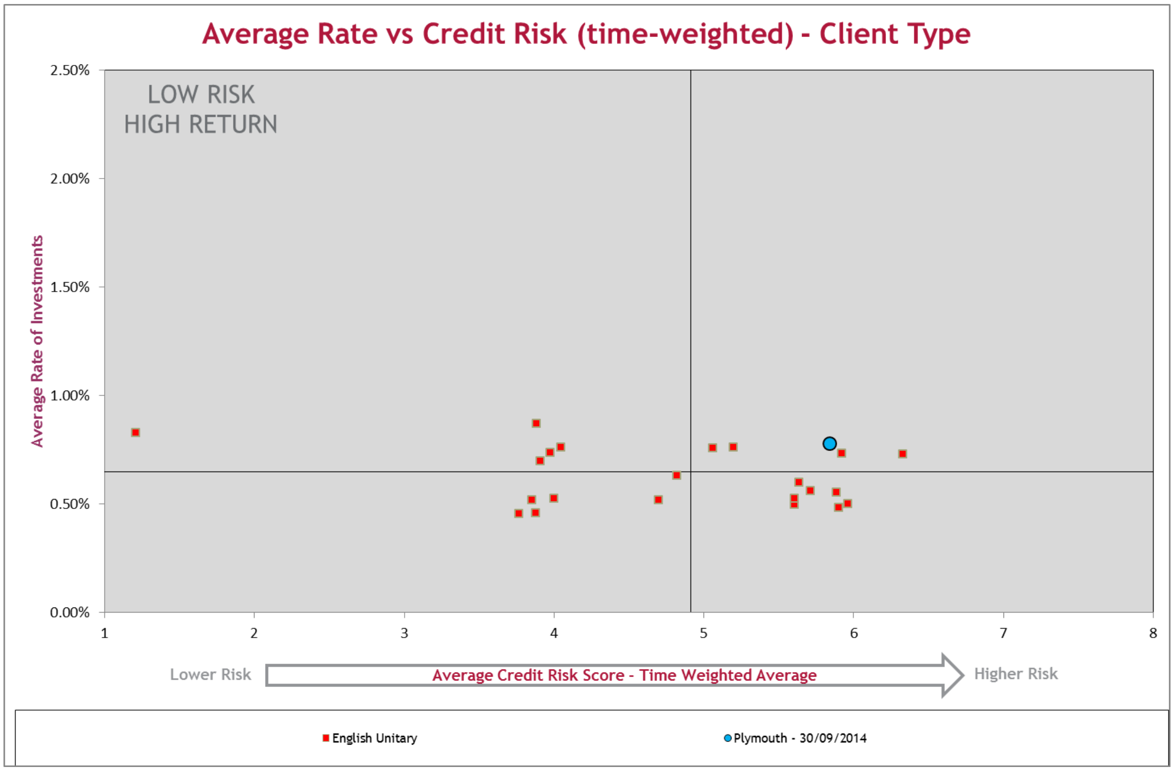
Graph 1 Average Number of days to Maturity V Return



Graph 2 Value Weighted Average Return



Graph 3 Time weighted Average V Return



6. Revenue Implications of Treasury Management

6.1 The expenditure and income arising from the Council's borrowing and investments accrues to the revenue accounts. The table below shows the monitoring positions against budget arising from these transactions in 2014/15 to 30th September 2014.

Table 4 Summary of Capital Financing Costs 2014/15

	2014/15 Budget £000	Forecast 2014/15 Outturn £000	Variance £000
External Interest payments	8,347	8,147	(200)
External Interest received	(936)	(1,136)	(200)
Interest transferred to other accounts	15	15	0
Premiums / Discounts written out to Revenue	(146)	(146)	0
Debt Management Expenses	126	126	0
Treasury Management Cost	**7,406**	**7,006**	**(400)**
Minimum Revenue Provision	8,394	8,194	(200)
Recharges for unsupported borrowing	(4,617)	(4,617)	0
Recovered from trading Accounts	(2,725)	(2,725)	0
Net Cost to General Fund	**8,458**	**7,858**	**(600)**

7. Compliance with Prudential Indicators

7.1 Under the arrangements set out in the Prudential Code for Capital Finance in Local Authorities, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the Code, and for establishing a range of prudential indicators covering borrowing limits and other Treasury Management measures. The Prudential Indicators for 2014/15 were approved by Council on 23rd January 2014.

Performance to 30th September 2014 against these limits is set out below:

7.2 <u>Gross Debt and the Capital Financing Requirement</u>

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for capital purposes, 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 for the current and next two financial years.

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31 March 2014 was estimated at £264.753m. At the start of the year total debt was £225.139m. By the 30th September this had increased to £229.788m, but still below the CFR. Short term cash flow requirements will sometimes mean the debt will be above the CFR but the Section 151 officer can report that the Authority had no difficulty meeting the requirement in the current year to date.

7.3 <u>Authorised Limit and Operational Boundary for External Debt</u>

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.

The Council's Affordable (Authorised) Borrowing Limit was set at £335m for 2014/15.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary may be breached at certain times during the year due to short-term cash flow requirements.

The Operational Boundary for 2014/15 was set at £312m.

There were no breaches to the Authorised Limit or Operational Boundary to 30th September 2014.

7.4 <u>Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure</u>

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

Table 5

	Limits for 2014/15 %
Upper Limit for Fixed Rate Exposure	210
Upper Limit for Variable Rate Exposure	60

The Council's exposure to both fixed and variable rates was managed well within the limits set during the first half of the year.

7.5 <u>Maturity Structure of Fixed Rate Borrowing</u>

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates, and is designed to protect against excessive exposure to interest rate changes.

It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The following table shows the limits during the year.

Table 6

Maturity Structure of Fixed Rate Borrowing	Upper Limit %
under 12 months	40
12 months and within 24 months	60
24 months and within 5 years	60
5 years and within 10 years	50
10 years and within 20 years	50
20 years and with 30 years	30
30 years and within 40 years	20
40 years and within 50 years	20
50 years and above	20

7.6 Total principal sums invested for periods longer than 364 days

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2013/14 was set at £30m and the estimate for 2014/15 is £40m.
- On the advice of the Council's advisers no deposits were made beyond 364 days during the first half of the year. Having not taken any deposits over 364 days in the first half of the year the Council still has space for longer-term deposits should this be viewed as appropriate in light of credit conditions, available counterparties and the risk/reward of these investments.

7.7 Credit Risk

- This indicator has been incorporated to review the Council's approach to credit risk.
- The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions.
- The Council can confirm that all investments were made in line with minimum credit rating criteria set in the 2014/15 Treasury Management Strategy.

8. Outlook for Q3-Q4

There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. At the time of writing this report, our advisors brought our attention to the risk of Barclays Bank and Deutsche Bank being downgraded below the A- threshold in the coming months. Where strategies permit, they have advised that new and unsecured investments with Barclays Bank and Deutsche Bank are restricted to a maximum period of 6 months. Arlingclose continues to forecast the first rise in official interest rates in Q3 and general market sentiment is now close to this forecast. There is a momentum in the economy, but inflationary pressure is benign and external risks have increased, reducing the likelihood of immediate monetary tightening.

Appendix 1 contains projected rates for Dec 2014 to March 2018.

9 Summary

9.1 In compliance with the requirements of the CIPFA Code of Practice, this report provides members with a summary of the Treasury Management activity during the first half of 2014/15. As indicated in this report none of the financial boundaries have been breached and a prudent approach has been taken in relation to investment activity and borrowing.

9.2 As part of the 2014/15 budget setting process we reduced the allocation to Treasury Management by £1m. This was to reflect the reduced interest costs resulting from the realignment of our LOBO debt at the end of last year. This report sets out the additional saving in-year currently forecast at £0.600m from our continuing policy of securing the best available rates from our investments.

9.3 In the two months since the period covered by this report, we have further diversified our investment portfolio. Following advice from our advisors, we have invested a further £5m in the Property Investment fund, taking our total investment from £10m to £15m. We are also talking to our brokers about two investments of £2.5m each in secure bonds, with a fixed coupon in excess of 1.45% for a maximum of eighteen months.

9.4 The LGA (Local Government Association) are in the process of setting up a Municipal Bonds Agency, with a view to improving the lending capabilities and reducing council financing costs. It will raise money on the capital markets through issuing bonds, arrange lending or borrowing directly from local authorities and source funding from other third party sources, such as banks, pension funds and insurance companies.

9.5 At this early stage, Plymouth City Council is still negotiating with the LGA to understand the short term and long term benefits of becoming an investor at this early pre-launch stage. More details will be included in future reports.

9.6 As part of the budget setting process, each year the Council is required to produce its annual Treasury Management Strategy and Annual Investment Strategy. This document forms a fundamental strategy within the overall budget and the report for 2015/16 will be included in the budget debate at Full Council in February 2015.

9.7 It is recommended that approval of the Treasury Management Strategy and Annual Investment Strategy 2015/16 is delegated to the Head of Corporate Strategy in consultation with the Chair and Vice Chair of the Audit Committee to agree a final version before being submitted to Full Council for authorisation in February 2015.

Appendix 1 - Projected Rates - Dec 14 – Mar 18

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
3-month LIBID rate													
Upside risk	0.05	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.55	0.60	0.65	0.85	1.00	1.15	1.30	1.45	1.60	1.75	1.85	2.05	2.15
Downside risk	0.10	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	-0.95	-0.95	-0.95	-1.00
1-yr LIBID rate													
Upside risk	0.10	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.95	1.00	1.05	1.20	1.35	1.50	1.65	1.80	1.95	2.10	2.20	2.40	2.50
Downside risk	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80	-0.80
5-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	1.70	1.75	1.90	2.00	2.10	2.20	2.30	2.40	2.50	2.60	2.70	2.90	2.95
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.60	-0.65	-0.70	-0.70	-0.70
10-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	2.40	2.45	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.05	3.10
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60
20-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	2.90	2.95	3.05	3.10	3.15	3.20	3.25	3.30	3.35	3.40	3.45	3.50	3.55
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.50	-0.55	-0.55	-0.60	-0.60	-0.60
50-yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	3.00	3.05	3.10	3.15	3.20	3.25	3.30	3.35	3.40	3.45	3.50	3.55	3.60
Downside risk	-0.30	-0.35	-0.35	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60