

Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy for 2016-17

1. Treasury Management Policy Statement

Chichester District Council defines its treasury management activities as:

- The management of the organisation's financial 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.
- The 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.
- The 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 comprehensive performance measurement techniques, within the context of effective risk management.
- The investment policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and the DCLG guidance require the Council 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 generation of investment income to support the Council's spending plans is an important, but secondary objective.
- The Council's borrowing objective, being debt free and with relatively substantial resources still available for its capital investment spending plans, means that it does not intend to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

2. Treasury Management Strategy Statement

The Treasury Management Strategy details the expected activities of the treasury function in the forthcoming year 2016-17. The publication of the strategy is a statutory requirement.

3. The Treasury Management Strategy Statement including **the** Annual Investment Strategy are underpinned by the CIPFA Code of Practice and Treasury Management Practices (TMPs) which provide prescriptive information as to how the treasury management function should be carried out.

4. Risk Appetite Statement

As a debt free authority with substantial balances to invest the Council's highest priority in its treasury management function is the security of those investments in accordance with the priorities set out in the CIPFA Code. The investment returns are **generally** used to fund one-off expenditure or capital investment, ~~and not to balance the revenue budget~~. Sums are invested with a diversified range of counter parties using a wide range of instruments consistent with avoiding the risk of the capital sum being diminished through movements in prices.

~~This means that~~ The Council whilst fundamentally risk adverse, will accept some modest degree of risk. It will consider first the range of risks as set out specifically in the Treasury Management Practices (TMP 1), and secondly how prudently to manage those different risks. It will ensure that priority is given to security and liquidity when investing funds before seeking to optimise yield. The use of different investment instruments and diversification of high credit quality counter parties along with country, sector and group limits, as set out in the Strategy, enables the Council to control the nature and extent of the different risks. One risk not set out in TMP1 which also needs to be considered when placing longer term investments is the political risk, such as in relation to a possible change of Government, any EU referendum, and their effect on the treasury management function.

~~In particular~~ When investing surplus cash, the Council will not necessarily limit itself to making deposits with the UK Government and local authorities, but may invest in other bodies including certain unrated building societies and money market funds. The Council may also invest surplus funds through tradable instruments such as gilts, treasury bills, certificates of deposit and corporate bonds. The duration of such investments will be limited so that they do not have to be sold (although they may be) prior to maturity, thus avoiding the risk of the capital sum being diminished through movements in prices.

External Context

5. Economic background

~~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 currently extremely 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 focus of the Monetary Policy Committee (MPC) of the Bank of England 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 MPC Committee. Despite two MPC members having voted for a 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 0.50% as there was sufficient risk that low inflation could become entrenched and the MPC Committee have become more concerned about the economic outlook.~~

~~Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth nationally is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 82nd consecutive month at its meeting in December 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.~~

~~The outcome of the UK general election, which was largely fought over the parties' approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the~~

outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course. In December 2015 the Federal Reserve raised its key interest rate by 25 basis points to between 0.25% and 0.50%, a move which was widely expected by the markets. Any future increases are expected to be gradual because their concerns about the global economy and low inflation. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

6. Credit outlook

The transposition of two European Union directives into UK legislation in January 2015 and by July 2015, 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 Council.

The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain stubbornly low.

7. Prospects for Interest Rates

The Council's treasury management adviser Arlingclose, forecasts the first rise in official interest rates around the third quarter of 2015 with 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 2.70%.

The Council's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and further US interest rate rises are likely to prompt short-term volatility in gilt yields.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.75% for 2016-17.

8. The table below shows the November 2015 HM Treasury Survey Medium Term forecasts for the average annual Official Bank Rate.

Table 1: HM Treasury Survey Medium Term Forecasts for Average Annual Official Bank Rate

	Average Annual Official Bank Rate %				
	2015	2016	2017	2018	2019
Highest	0.60	1.20	1.80	2.50	3.10
Average	0.50	0.80	1.40	2.10	2.50
Lowest	0.40	0.60	1.20	1.40	1.60

Source: HM Treasury Forecasts for the UK economy: November 2015.

For the purpose of setting the budget, it has been assumed that new investments will be made yielding an average rate of 0.75% for 2016-17.

9. Current Portfolio Position

The Council's treasury portfolio position as at 8 January 2016 comprised:

Table 2: Current Investment Portfolio Position.

Investments	Actual Portfolio £m	Annualised Average Rate %
Call Accounts	12.865	0.41
Short Term investments	34.000	0.50
Medium Term Investments	12.000	1.52
Long Term Investments	3.000	1.85
Total Investments	61.865	0.60

Forecast changes in these sums are shown in the balance sheet analysis in table 3 below.

Definitions of investment periods are:

- (i) Short Term - up to one year (excluding call accounts with immediate access to funds)
- (ii) Medium Term - One to four years
- (iii) Long Term - Over four years

Table 3: Balance Sheet Summary and Forecast

	31.3.15 Actual £m	31.3.16 Estimate £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m	31.3.21 Estimate £m
General Fund CFR	-1.440	-1.316	-1.341	-1.367	-1.396	-1.427	-1.440
Less: Other Debt Liabilities	-0.124	0.025	0.026	0.029	0.031	0.013	0.0
Borrowing CFR	-1.316	-1.341	-1.367	-1.396	-1.427	-1.440	-1.440
Internal borrowing	0	0	0	0	0	0	0
Usable reserves	-34.700	-31.995	-33.822	-29.947	-29.565	-28.737	-28.415
Working capital	-4.685	-2.679	-2.505	-2.779	-2.803	-2.879	-2.933
Investments	40.700	36.015	37.694	34.122	33.795	33.056	32.788

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 Council is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £ 32.788m as capital receipts and other revenue resources are used to finance capital expenditure, and reserves are used to finance specific projects and one off revenue expenditure.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 3 shows that the Council expects to comply with this recommendation during 2016-17 as it maintains its debt free status.

10. Borrowing Strategy

As part of the Council's Financial Strategy the Resources and Capital Principles are stated as:

“Borrowing could be used for “invest to save” projects providing the cost of servicing the debt is contained within the revenue savings/income the project generates. The payback period for invest to save projects should be shorter than the life of the asset.

- (a) ~~At present, £~~There are no plans to borrow to finance new capital expenditure in the current 5 year plan but this remains an option if deemed to be prudent. Short term internal borrowing (for schemes that pay back within the 5 year time frame of the capital programme) can be accommodated without incurring external interest charges, provided the resulting savings are recycled into reserves. Longer term pay back periods will have to accommodate both the external interest and a minimum revenue provision (MRP) in accordance with the Council's MRP policy, which links repayment of the debt to the life of the asset.
- (b) Borrowing would add pressure on the revenue budget as MRP and interest would become payable. The capacity to make these payments would need to be identified in advance, namely the further efficiency savings generated by the investment in the assets.”

11. Borrowing Objectives:

If it considers it necessary to borrowing money, the Council's chief objective is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

12. Borrowing Strategy

The Council may need to borrow money in the short term to cover unexpected cash flow shortages, (normally up to one month) within the approved operational boundary limit of £5m.

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

- Public Works Loans Board (PWLB) and any successor body
- 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 (except the West Sussex Pension Fund)

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 Initiatives
- Sale and leaseback

13. Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's financial investment balance has ranged between £37.5 and £60.95 million, but this is expected to reduce to lower levels in the forthcoming year due to the anticipated capital spending programme including any property investment commitments.

14. **Objectives:** The Council has a duty to safeguard the public funds and assets it holds on behalf of its community. Both the CIPFA Code, and the CLG Guidance require the Council 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 Council'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.
15. **Strategy:** Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2016-17. This is especially the case for the estimated £20.45m that is available for longer-term investments. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, and other local authorities. The new investment options that may be undertaken by this strategy would now include covered bonds, Government Agency Bonds, Supranational Bonds and Corporate Bonds. This diversification will ~~therefore~~ represent a continuation of the new strategy adopted in 2015-16-material change in strategy over the coming year, in order to manage the bail-in risk and spread the investment of surplus funds in a wider range of investment types.
16. The Council may invest its surplus funds with any of the counterparties in table 4 below, subject to the cash limits (per counterparty) and time limits shown.

Table 4: Approved Investment Counterparties

Sector Limits/ Credit Rating	Banks Unsecured ¹ £20m	Banks Secured ¹ Unlimited	Government Unlimited	Corporates £10m
UK Govt	n/a	n/a	£ Unlimited 15 5 years	n/a
AAA	£2.5m 5 years	£5m 10 5 years	£5m 10 5 years	£2.5m 10 5 years
AA+	£2.5m 5 years	£5m 7 5 years	£5m 7 5 years	£2.5m 7 5 years
AA	£2.5m 4 years	£5m 5 4 years	£5m 5 4 years	£2.5m 5 4 years
AA-	£2.5m 3 years	£5m 4 3 years	£5m 4 3 years	£2.5m 4 3 years
A+	£2.5m 2 years	£5m 3 2 years	£2.5m 3 2 years	£2.5m 3 2 years
A	£2.5m 13 months	£5m 2 years 13 months	£2.5m 2 years 13 months	£2.5m 2 years 13 months
A-	£2.5m 6 months	£5m 13 months	£2.5m 13 months	£2.5m 13 months
BBB+	£1m 100 days	£2.5m 6 months	n/a	£1m 6 months
BBB or BBB-	£1m next day only	£2.5m 100 days	n/a	n/a
None	£1m 6 3 months	n/a	N/A £5m 10 years	£2m 5 or 10 years n/a
Money Market Funds Pooled Funds	£5m per money market fund and a maximum £10m in the Property Fund			

This table must be read in conjunction with the detailed notes below and limits stated in Table 6.

¹ Note: The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

17. 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.
18. Current Account Bank: Following a competitive tender exercise held in 2008, the Council's current accounts are held with HSBC plc which is currently rated above the minimum rating in table 4.
19. 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 capital loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

20. **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the banks' 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.
21. **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 the bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts up to 15 years.
22. **Corporates:** Loans, bonds and commercial paper issued by companies other than banks. These investments are not subject to bail-in, but are exposed to the risk of the company becoming insolvent.
23. ~~**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 Council. 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.~~
23. **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 which can range between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. Short-term Money Market Funds that offer same-day liquidity and very low volatility 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.
24. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into further 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 Council's investment objectives will be monitored regularly.
25. **Risk Assessment and Credit Ratings:** The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. Credit ratings are obtained and monitored by the Council's treasury advisor, 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
- If in the case of a decision to recall or sell an investment at a cost which is over the approved virement limits, the Council's urgent action procedure in its Constitution would be invoked by officers.
26. 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 in a timely manner 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. Any counterparty downgrades must be included in the monthly monitoring reports sent to the members of the Corporate Governance & Audit Committee.

27. **Other Information on the Security of Investments:** The Council 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.
28. 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 Council 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 Council’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.
29. **Specified Investments:** 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 Council defines “high credit quality” organisations 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 AAA. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

30. **Non-specified Investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Council 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 medium and 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 5 below.

Table 5: Non-Specified Investment Limits

	Cash limit
Total medium and long-term investments	£20.15m
Total investments without credit ratings or rated below A- BBB-	£10m
Total Limit on non-specified investments	£30.25m

31. Use of Specified and Non-Specified Investments

The selection of specified and non-specified investments will be undertaken by the Head of Finance and Governance Services who will keep the making of such investments under continuous review in the light of risk, liquidity and return and the framework set out in this Strategy. ~~A schedule will be included in the Council's TMP's for staff and circulated to members as a background paper to the strategy and when/if it is updated during the year.~~

Investment Limits: The Authority's uncommitted revenue reserves available to cover investment losses are forecast to be ~~£19.5m~~ ~~18.4~~ million on 31st March 2016. These uncommitted reserves include the following items; General Fund Balance £5m, Revenue Support £1.3m, New Homes Bonus ~~£4.9m~~ ~~4.7~~m and currently ~~£8.3m~~ ~~7.4~~m uncommitted resources as stated in the current estimated Resources Statement, ~~reported to Cabinet in February 2015~~. In order that no more than ~~25%~~ ~~27%~~ 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 £5 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts, foreign countries and industry sectors as set out in Table 6. below: Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 6: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
<u>Any group of pooled funds under the same management</u>	<u>£10m per manager</u>
Negotiable instruments held in a broker's nominee account	£10m per broker with Max of £5m in covered bonds
Foreign countries	£5m per country
Unsecured investments with Building Societies	£5m in total
<u>Loans to unrated corporates</u>	<u>£2m in total</u>
Money Market Funds	£10m in total

32. Liquidity management: The Council uses spread sheets for cash flow forecasting 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 medium and long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

33. Treasury Management Indicators

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

- a. **Security:** The Council 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.

Table 7: Portfolio Average Credit Rating	Target
Portfolio average credit rating	A+

- b. **Liquidity:** The method for cash flow forecasting is set out in paragraph 31.

The Council seeks to maintain its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments and minimising the use of its overdraft facility of £350,000.

The liquidity measure is to have a minimum of £10m available within 3 months.

- c. **Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk. Under the TM Code the upper limits on fixed and variable rate interest rate exposures, should be expressed as the amount or proportion of net principal borrowed or interest payable, with investments counting as negative borrowing. As the Council is debt free and to provide a meaningful indicator the limits on fixed and variable rate interest rate exposures are expressed as an amount and percentage of net principal of investments: Strictly this is contrary to the TM Code definition.

Table 8: Upper Limits on Interest Rate Exposures

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure of net investment principal	£28m £24m /40%	£24m £22m /40%	£22m £20m /40%
Upper limit on variable interest rate exposure of net investment principal	£70m £60m /100%	£60 m £55m /100%	£55m £50m /100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months the whole financial year, measured from the start of the financial year or the transaction date if later. Instruments that mature during the financial year are classed as variable rate.

~~Performance measure of a time weighted average v interest rate risk exposure, such that the investment portfolio should be in the range of below 5 credit risk score.~~

- d. **Maturity Profile of Borrowing**

As the Council is debt free it currently holds no fixed long term borrowing for which a maturity profile exists.

- e. **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:

Table 9: Principal Sums Invested for Periods Longer than 364 days

	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£20m £15m	£15m £9m	£10m £6m

Table 9 sets out the upper limit for each forward financial year period for the maturing of investments for periods longer than 364 days up to their final maturities beyond the end of the financial period. The limit for 2016-17 equals the total medium and long term investment limit stated in table 5. The next two financial year limits are smaller, effectively limiting the investments that can be made for longer than 2 years and 3 years. In essence this reflects a maturity pattern of the medium and long term debt, in that £5m should mature in 2016-17, and another £5m in 2017-18. The remaining balance would mature beyond 2018-19, up to maximum period of investments allowed as set out in table 4, but no longer than 2019/20.

34. Other Items

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

35. 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 Council 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 Council 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 and forward starting transactions 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.

The use of any derivative will be explicitly explained to the Corporate Governance & Audit Committee in relation to the risk being managed, except in relation to forward deals, as these are undertaken as part of cash flow management.

36. Investment Training:

Member and officer training is an essential requirement in terms of understanding roles, responsibilities and keeping up to date with changes and in order to comply with the CIPFA Treasury Management Code of Practice.

The training needs of the officers involved on treasury management are identified through the annual performance and development appraisal process, and additionally when the responsibilities of individual members of staff change. Staff attend relevant training courses, seminars and conferences.

To address the training need of members, training will be provided to members of both Cabinet and the Corporate Governance and Audit Committee in advance of them considering the forthcoming year's strategies. The training was provided by the Council's treasury adviser in October 2015.

37. Treasury Management Advisers: The Council currently contracts with Arlingclose Limited as its treasury management adviser and receives specific advice on investment, debt and capital finance issues. However, responsibility for final decision making remains with the Council and its officers.

The quality of this service is controlled and monitored against the contract by the Accountancy Services Manager, which is in place until the 30th June 2018.

38. Reporting Arrangements

The Council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities and on the performance of the treasury management function.

The Council/Cabinet will receive as a minimum:

- An annual report on the strategy and plan to be pursued in the coming year and on the need to review the requirements for changes to be made to the Treasury Management Strategy Statement.
- A mid-year review
- An annual report on the performance of the treasury management function, on the effects of decisions taken and the transactions executed in the past year, such reports to be submitted by 30th September in the succeeding financial year, including any circumstances of non compliance with the organisation's treasury management policy statement and Treasury Management Practices.

The body responsible for scrutiny, Corporate Governance and Audit Committee has responsibility for the scrutiny of treasury management policies and practices.

The Cabinet member for Finance and Governance, and the members of the Corporate Governance & Audit Committee receive monthly monitoring reports of the investments held. The monthly reports should include any negative outlook for investment vehicles used by the Council and appropriate benchmarking.

The Council reports their treasury management indicators as detailed in the sector specific guidance notes; which are set out in an appendix to the Treasury Management Strategy Statement for the Prudential Indicators and Treasury Management Indicators of this report for the forthcoming year, and reported for the out turn in the June after the year end.

39.

39. **Investment of Money Borrowed in Advance of Need:** As the Council does not anticipate the need to borrow in the foreseeable future, except in the short-term for cash flow purposes only, it is therefore not expecting to borrow in advance of need, and so does not need to set out any operational criteria for this situation in the 2016-17 Strategy.

40. Financial Implications

The budget for investment income in 2016-17 is £0.270million, based on an average investment portfolio of £36.015million at an interest rate of 0.75%. If actual levels of investments and actual interest rates differ from those forecast, performance against budget will be correspondingly different and may impact the intended use of investment income as set out in the Council's Financial Strategy.