h&f the low tax borough	London Borough of Hammersmith & Fulham **AUDIT, PENSIONS AND STANDARDS COMMITTEE** **13 FEBRUARY 2014**

TREASURY MANAGEMENT STRATEGY REPORT 2014/15

Report of the Leader of the Council – Councillor Nicholas Botterill

Open Report

Classification - For Decision

Key Decision: Yes

Wards Affected: All

Accountable Executive Director:

Jane West, Executive Director of Finance and Corporate Governance

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1. EXECUTIVE SUMMARY

1.1 The report sets out the Council's Treasury Management Strategy for 2014/15. The Committee is asked to comment on the measures proposed.

2. RECOMMENDATIONS TO AUDIT, PENSIONS AND STANDARDS COMMITTEE

2.1 That the Committee review the 2014-15 Strategy, and submit any comments to the meeting of full Council on the 26 February 2014, which will approve it.

3. RECOMMENDATIONS TO CABINET AND COUNCIL

3.1 To approve the future borrowing and investment strategies as outlined in this report and authorise the Executive Director of Finance and Corporate Governance to arrange the Council's cashflow, borrowing and investments in 2014/15.

3.2 In relation to the Council's overall borrowing for the financial year note the comments and the Prudential Indicators as set out in this report.

3.3 To pay the HRA investment income on unapplied HRA receipts and other HRA cash balances calculated at the average rate of interest earned on temporary investments with effect from 1 April 2014.

4. BACKGROUND

4.1 Treasury Management is defined by the CIPFA[1] Code of Practice as '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.'

4.2 The Council is required to receive and approve, as a minimum, three main reports each year: a Treasury Strategy Report (this report), Mid-year report and an Outturn report. These reports are required to be adequately scrutinised before being recommended to the Council by the Cabinet. This role is undertaken by the Audit, Pensions and Standards Committee and the Overview and Scrutiny Board.

4.3 The Treasury Management Strategy is set out in section 6 of this report, and the remainder of the report cover the following list. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and CLG Investment Guidance.

- prospects for interest rates;
- the current treasury position;
- the proposed investment strategy;
- the borrowing strategy;
- prudential indicators; and,
- approach to debt rescheduling.

4.4 The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cashflow and, where capital plans require, the organisation of appropriate borrowing facilities. The function

[1] Chartered Institute of Public Finance and Accountancy

covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual investment strategy.

4.5 Under regulations set out by the (now called) Department for Communities and Local Government (CLG) in 2003, a Council's investment policy needs to cover so-called "specified investments" and "non-specified investments". A specified investment is defined as an investment which is denominated in sterling, is less than one year, is made with a body or scheme of high credit quality, UK Government or UK local authority and does not involve the acquisition of share capital or loan capital in any body corporate. Non-specified investments are those that do not meet these criteria.

4.6 Section 6 of this report sets out the investment approach, and takes account of the specified and non-specified approach. The Council is likely only to consider non-specified investments where an investment is made for longer than one year.

4.7 The CIPFA recommendations contained in the Code of Practice and Cross-Sectoral Guidance Notes issued as a revised version in 2011 for Treasury Management in the Public Services require that each Local Authority has a Treasury Management Policy Statement that is approved by the Full Council. This is set out in Appendix A of this report.

5. PROSPECTS FOR INTEREST RATES

5.1 There has been a general improvement in the overall condition of the global economy in 2013. The sovereign debt crisis has eased over the course of the year.

5.2 In the UK, the slow economic recovery gained pace in 2013(Q1 +0.3%, Q2 +0.7% and Q3 +0.8%), surpassing all expectations with strong upturns in all three main sectors services, manufacturing and construction. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone where growth is likely to remain weak and so will dampen UK growth. However, the Eurozone finally escaped from seven quarters of recession in Q2 of 2013 and growth rose by a modest 0.1% in Q3.

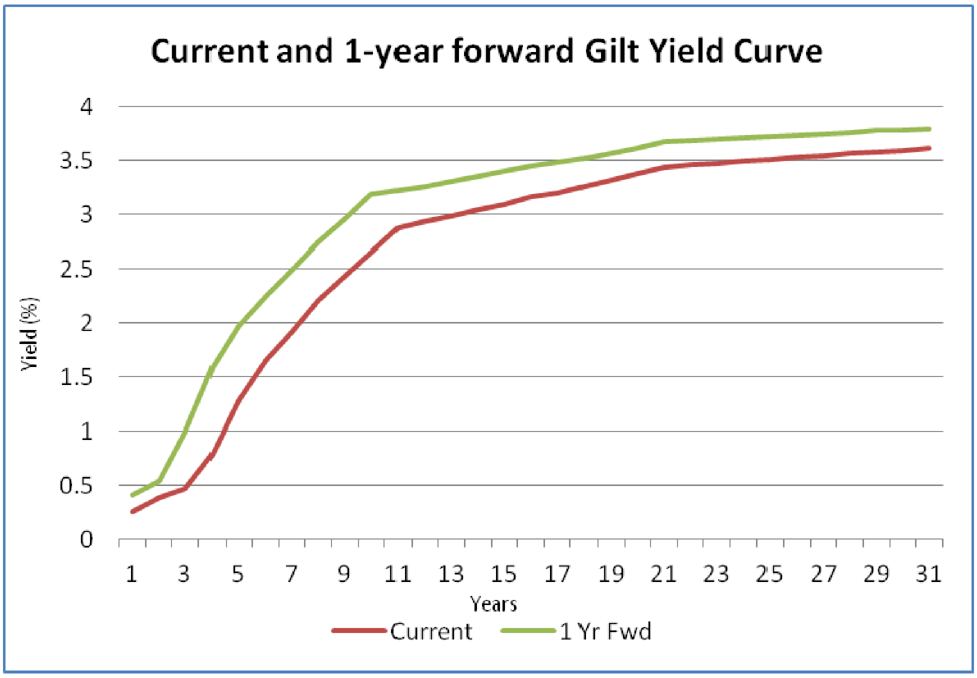
5.3 The United States has managed to return to solid growth in spite of the fiscal cliff induced cuts in federal expenditure and increases in taxation that are due in March 14.

5.4 Economic forecasts remain difficult with so many external influences weighing on the UK. Major volatility in bonds yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets for example equities, and safer bonds.

5.5 Gilt yields could be volatile over the next year as financial markets await the long expected start of tapering of assets purchases by the US Federal Reserve. The timing and degree of tapering could have a significant effect on both Treasury and gilt yields.

5.6 The longer trend is that gilt yields and PWLB rates will rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will encourage investors to switch back from bonds to equities.

5.7 The graph below shows the current UK Gilt Curve together with the one-year forward Gilt curve (i.e. current market expectations for the Gilt rate in 12 months time).



Source: Bloomberg

5.8 The low interest rate has a disproportionate effect on the Council, as the Council has no expectation of borrowing in the near future (so cannot benefit from the low borrowing rates), it is impacted to a greater extent by the cost of carrying debt.

6. CURRENT TREASURY POSITION

6.1 As at the 31st December 2013, the Council had £284 million cash investments. The cash is made up of the Council's usable reserves, capital receipts and unspent government grants. Although the level of cash has increased by £78 million to date this year it is anticipated further increases in cash levels will slow for the remainder of the year to approximately £300 million (Business Rate/Council Tax cycle limited collection during January to March).

6.2 The Council has for a number of years maintained a policy of debt reduction in order to deliver savings to the General Fund through reduced debt service payments. No new borrowing has been undertaken since November 2009 and where borrowings have fallen due for repayment, they have not been replaced. This has been the policy for both the General Fund and HRA. Officers periodically review the possibility of the early redemption of external debt.

6.3 The forecast closing General Fund debt as measured by the Capital Financing Requirement (CFR) for 2014/15 is £66.5m and is subject to a projected surplus in General Fund capital receipts of £9.5m being applied to reducing the CFR. It should be noted that the 2014/15 debt reduction target of £10.8m is based on an assumption of General Fund forecast receipts of £22.7m (net of costs of disposal) being realised. These are summarised in the Capital Programme Report. The actual level, and timing, of sales is subject to certain risks – most notably a dependence on the wider property market, appropriate consultation and planning considerations. The Council continues to review its asset holdings to identify potential further disposals, although having obtained significant capital receipts in the past 3 years the General Fund asset portfolio is being significantly rationalised in the period to 2017/18. The target for forecast sales is ambitious and a risk is identified within the Medium Term Financial Strategy that sales may slip or not be achieved. An additional risk is that significant cost of disposals of assets may be incurred, which can be difficult to predict in some cases.

6.4 The CFR measures an authority's underlying need to borrow for a capital purpose. It is considered by the Chartered Institute of Public Finance Accountancy (CIPFA) as the best measure of Council debt as it reflects both external and internal borrowing. It was introduced by the Government in 2004 and replaced the 'credit ceiling' as the Council's measure of debt.

6.5 The CFR is the difference between capital expenditure incurred and the resources set aside to pay for this expenditure. Put simply it can be thought of as capital expenditure incurred but not yet paid for in-full and serves as a measure of an authority's indebtedness. An important caveat is that the CFR does not necessarily equal the outstanding loans of the authority. A council may be 'cash rich' and pay for a new asset in full without entering into new loans. However unless the council simultaneously sets aside reserves (either through recognising a revenue cost or transferring existing reserves from 'usable' to 'unusable') the CFR will increase. In this example the authority has effectively borrowed internally. The CFR should therefore be thought of as the total of internal and external borrowing.

6.6 There are 5 Prudential Indicators for 2014/15 relating to capital stated in the Capital Programme 2014/15 to 2017/18 report to Budget Council on 26th February 2014, (to meet CIPFA's Prudential Code requirements).

6.7 The Council's borrowing and Capital Financing Requirement (CFR) positions are summarised in the tables below.

Current Portfolio Position

(£ 000)	**2012/13 Actual**	**2013/14 Estimate**	**2014/15**	**2015/16**	**2016/17**
Borrowing at 1 April	262,166	262,067	250,511	247,599	231,897
Expected change in borrowing during the year	(99)	(11,556)	(2,912)	(15,703)	(7,074)
Actual Borrowing at 31 March	**262,067**	**250,511**	**247,599**	**231,897**	**224,823**
Total investments at 31 March	(206,168)	(300,000)	(250,000)	(240,000)	(240,000)
Net borrowing/(investment)	**55,899**	**(49,489)**	**(2,401)**	**(8,103)**	**(15,177)**

Borrowing at Year-end: Split between the Housing Revenue Account and General Fund

(£ 000)	**2012/13 Actual**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
Housing Revenue Account	217,299	207,717	205,302	192,283	186,417
General Fund	44,768	42,794	42,297	39,614	38,406
Total	**262,067**	**250,511**	**247,599**	**231,897**	**224,823**

CFR: General Fund and HRA.

(£ 000)	**2012/13 Actual**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
General Fund	78,382	77,347	66,522	46,272	33,679
HRA	217,299	207,717	205,302	192,282	186,416

Total	295,681	285,064	271,824	238,554	220,095

7. ANNUAL INVESTMENT STRATEGY

7.1 The Council must have regard to the Guidance on Local Government Investments issued by CLG and the 2011 revised CIPFA's Treasury Management in Public Services of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

7.2 This section sets out the Council's annual investment strategy for 2014/15 and any proposed changes from the 2013/14 Treasury Management Strategy, the table below summarises the maximum amounts and tenors of investments that the Council can hold. The table also shows the maximum proposed limits that Officers can work within. In reality, neither the amounts nor tenors of the proposed investments are likely to be at the maximum level proposed.

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment	Treasury Management Strategy 2013/14
DMO Deposits	UK Government Rating	Unlimited	6 months	No change
UK Government (Gilts / T-Bills / Repos)	UK Government Rating	Unlimited	Unlimited	No change
Supra–national Banks	AA+ / Aa1 / AA+	£30m	3 years	£10m / 1 year
European Agencies	AA+ / Aa1 / AA+	£10m	1 year	No change
Network Rail	UK Government Rating	Unlimited	Oct 2052	£25m / 1 year
TFL	AA- / Aa3 / AA-	£30m	3 years	New for 14/15 Previously part of LA £25m/ 1 year
GLA	NA	£30m	3 years	New for 14/15 Previously part of LA £25m/ 1 year
UK Local Authorities	NA	£10m per Local Authority, £50m in aggregate	6 months	£25m/ 1year
Commercial Paper issued by UK corporate	A-1 / P-1 / F-1	£15m per name, £75m in aggregate	Six months	£10m per name, £50m in aggregate
Money Market Funds MMF	AAA / Aaa / AAA be AAA by at least two of the main credit agencies	£15m per fund manager, £90m in aggregate	Three day notice	£10m per fund manager, £60m in aggregate / One month
Enhanced Money Funds	AAA / Aaa / AAA by at least one of the main credit agencies	£10m per fund manager, £30m in aggregate	Up to seven day notice	£5m per fund manager, £10m in aggregate / One month

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment	Treasury Management Strategy 2013/14
UK Bank	AA- / Aa3 / AA- and above (or UK Government ownership of greater than 25%), subject to minimum ST ratings	£70m	3 years	£35m and 35% Government ownership/ £25m/ 1 year/
UK Bank	A- / A3 / A- and above, subject to minimum ST ratings	£30m	Six months	£25m / Three months
Non-UK Bank[2]	AA- / Aa2 / AA- and above, subject to minimum ST ratings	£30m	1 year	£25m / Six months
Non-UK Bank	A / A2 / A and above, subject to minimum ST ratings	£15m	Six months	£10m / Three months

7.3 The remainder of this section six covers the following in further detail:

- Current investment types
- Changes for the 2014/15 Treasury Management Strategy
  - Greater London Authority counterparty limit
  - Transport for London counterparty limit
  - Network Rail Infrastructure
  - Changes to Money Market Funds and Enhanced Money Fund
  - Floating Rate Notes as a new assets class
- Proposed changes to investment limits and tenors
- Non-specified investments
- Local authority investments
- Creditworthiness criteria
- Country limits.

Current Investment Types[3]

7.4 As per the 13/14 Treasury Management Strategy, it is proposed that for 14/15 the Council can continue to invest in financial institutions, external funds and certain capital market instruments as set out below. All investments would be in Sterling. The investment types listed below are as per the current TMS.

(i) Investment with the Debt Management Office with no financial limit (UK government guaranteed)

(ii) Investment in financial institutions of a minimum credit rating, with the parent company domiciled only in certain jurisdictions;

[2] Any investments in Non-UK Banks is subject to the Leader of the Council approval.
[3] Appendix B provides more detail on the various asset classes.

(iii) Investment in UK Treasury Bills (T-Bills) and Gilts (conventional or indexed-linked) with no financial limit (UK government guaranteed)

(iv) Investments in UK Government repurchase agreements ("Repos" and "Reverse Repos");

(v) Lending to certain public authorities (Unitary Authorities, Local Authorities, Borough and District Councils, Met Police, Fire and Police Authorities)

(vi) Investment in close to maturity AAA-rated corporate bonds and commercial paper backed by UK Government guarantees;

(vii) Investment in supra-national AAA-rated issuer bonds and commercial paper;

(viii) Investment in AAA-rated Sterling Money Market Funds and longer term funds;

(ix) Investment in commercial paper (CP) of UK domiciled entities with minimum short term credit rating of A1/P-1/F-1.

7.5 In determining whether to place deposits with any institution or fund, the Tri–borough Director for Treasury and Pensions will remain within the limits set out above, but take into account the following when deciding how much to invest within the limit set out above:

(i) the financial position and jurisdiction of the institution;

(ii) the market pricing of credit default swaps for the institution;

(iii) any implicit or explicit Government support for the institution;

(iv) Standard & Poor's, Moody's and Fitch's short and long term credit ratings;

(v) Core Tier 1 capital ratios; and

(vi) other external views as necessary.

<u>Changes for the 2014/15 Treasury Management Strategy</u>

7.6 Officers are proposing various changes to the 14/15 Treasury Strategy, in part to reduce reliance on the Debt Management Office and to provide some flexibility for better investment returns, within the structure of a cautious investment outlook. Officers remain concerned that the DMO may seek to reduce its rates further from 0.25% as at present, if a low interest rate environment continues.[4]

7.7 While building on the Treasury Management Strategy for 13/14, the proposals for 2014/15 make a recommendation for the creation of individual investment limits for the Greater London Authority (GLA) and Transport for London (TfL), change the existing Network Rail Infrastructure counterparty limit, adjustments to the current money market fund limits, the use of floating rate notes (FRNs) as a new asset class and an increase in the maximum tenor and maximum investment limit overall.

<u>Greater London Authority (GLA) counterparty limit</u>

7.8 Due to the nature and significance of this body a £30 million standalone limit with a maximum maturity of three years is proposed and remove the GLA from the local authority

[4] As an example, on 31 December 2013, the DMO offered an overnight deposit rate of 0.0% due to illiquidity in the market.

counterparty group. The GLA is classed as a local authority by legislation, and thus all borrowings by the GLA are secured[5] on a pari passu basis against all its revenues (net expenditure[6] in 2012/13 was £1.8 billion). Lending to the GLA would most likely be through a bi-lateral loan (either directly or via a broker).

<u>Transport for London (TfL) counterparty limit</u>

7.9 Under the 2013/14 TMS, the Council can invest in TfL (mainly via its Commercial Paper programme) for up to £10m and a six-month maximum. For 2014/15, it is proposed for TfL to have their own standalone limit of £30 million for up to three years, in line with the GLA, given the significance of TfL and implied support from the UK Government. TfL is also considered a Local Authority for financial regulation all its borrowing is secured on all its revenues on a pari passu basis. In 2012/13, its revenues were £9.96 billion. Lending to TfL would continue via Commercial Paper (rarely issued for more than six months) and would enable purchase of any near to maturity bonds.

<u>Network Rail Infrastructure</u>

7.10 All borrowing by Network Rail is directly and explicitly guaranteed by the UK government to October 2052. Given this explicit support by the UK Government, and that Network Rail bonds (when available) offer a better rate than Gilts, it is proposed that the 2014/15 limit for Network Rail is made unlimited with the maximum maturity of five years.

<u>Changes to Money Market Funds (MMFs) and Enhanced Money Fund (EMFs):</u>

7.11 Appendix D sets out the difference between MMFs and EMFs in more detail. However, the 2013/14 TMS limit for both MMFs and EMFs was £60m in aggregate with a maximum £10m per fund. As the funds are different it is recommended that the existing limits should be split and treated separately for both types of funds.

7.12 The new limit for MMFs is set with reference to a panel of eight fund managers with a maximum aggregate investment of £90 million in total with a maximum individual limit of £15 million per fund. All MMFs must offer three day access or better.

7.13 EMFs seek to outperform the MMFs by investing in longer dated investments. As such they are not used to provide same day liquidity but should be used to invest cash for a minimum of three months. The proposed limits for EMFs are a maximum aggregate investment of £30m with a maximum individual limit of £10m per fund (subject to fund size). A maximum period of seven days notice will apply.

<u>Floating Rate Notes (FRNs) as a new assets class</u>

7.14 FRNs are debt instruments that pay a floating rate of interest that resets at an agreed interval (3 or 6 monthly) with reference to a published rate such as UK LIBOR. While FRNs would be a new asset class for the Council, the counterparties with whom the Council could place its funds will remain the same as per the current Treasury Management Strategy. Issuers of FRNs include banks, supranational banks and European agencies.

<u>Proposed changes to investment limits and tenors</u>

[5] Section 13, Local Government Act 2003

[6] By legislation, all Local Authorities (including TfL) must prepare a balanced budget, taking into account all its revenues and expenditure.

7.15 The Council's investment counterparty limits have been unchanged over the last two years, despite average council cash balances increasing (due in part to capital receipts). Given the more stable economic environment, together with the strict counterparty criteria used by Officers, it is proposed that limits and tenors of investment are extended for certain investments.

7.16 The 2013/14 MMFs limit (contains both MMFs and EMFs) is £60 million in aggregate and it is proposed that it is raised to £90 million for MMFs with a separate limit for EMFs of £30 million in aggregate.

7.17 The Council places investments / deposits with only four UK banks – Barclays, HSBC, Lloyds and RBS (Nat West). For UK banks with Government ownership (and given the increased relative stability over the last 2-3 years), it is proposed that the minimum percentage of UK Government ownership (to qualify within this strategy for such criteria) is reduced from 35% to 25%. RBS and Lloyds would fall into this category, and this change in minimum ownership criteria allows Lloyds to remain a counterparty of the Council. Given the implied Government support, it is also proposed that the maximum limit for each institution is raised from £35 million to £70 million.

7.18 For UK banks with a minimum credit rating of AA-/Aa3/AAA and above it is proposed that the maximum individual investment limit is increased from £25m to £70m and the maximum tenor of investment is changed from one to three years.

7.19 UK banks with a minimum credit rating of A-/A3/A- and above it is proposed that the maximum individual investment limit is increased from £25m to £30m and the maximum tenor of investment is changed from three to six months.

7.20 Non-UK banks with a minimum credit rating of AA-/Aa2/AA- and above, it is recommended that the maximum individual investment limit is increased from £25m to £30m and that the maximum tenor of investment is changed from six months to one year.

7.21 Non-UK banks with a minimum credit rating of A/A2/A and above, it is recommended that the maximum individual investment limit is increased from £10m to £15m and that the maximum tenor of investment is changed from three to six months.

7.22 In summary, the bank investment limits are shown in the table below.

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment
UK Bank	With UK Government ownership of greater than 25%.	70	Three years
UK Bank	AA- / Aa3 / AA- and above subject to minimum ST ratings	70	Three years
UK Bank	A- / A3 / A- and above, subject to minimum ST ratings	30	Six months
Non-UK Bank	AA- / Aa2 / AA- and above, subject to minimum ST ratings	30	One year
Non-UK Bank	A / A2 / A and above, subject to minimum ST ratings	15	Six months

Non-specified investments

7.23 Under section 15(1) of the Local Government Act 2003, restrictions are placed on Local Authorities around the use of so-called specified and non-specified investments. A specified investment is defined as an investment which satisfies all of the conditions below:

(i) The investment and any associated cash flows are denominated in sterling ;

(ii) The investment has a maximum maturity of one year;

(iii) The investment is not defined as capital expenditure; and

(iv) The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

7.24 A non-specified investment is any investment that does not meet all the conditions above. The only likely non-specified investment that the Council may make is for any investment greater than one year. For such an investment, a proposal will be made to the Executive Director of Finance and Corporate Governance and Leader of the Council on the recommendation from the Tri Borough Director of Treasury and Pensions after taking into account cash flow requirements, the outlook for short to medium term interest rates and the proposed investment counterparty.

7.25 Long term investments (for periods over 364 days) will be limited to no more than £70 million.

Local Authority investments

7.26 It is recommended that the maximum tenor of investments to local authorities (other than TfL or the GLA) is reduced to six months, and the maximum individual limit is reduced from £25 million to £10 million with an aggregate of £50 million for the investment class as a whole.

Creditworthiness Criteria

7.27 As has been the case for 2013/14, the Council's investment priorities continue to be the security of capital and the liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

7.28 In accordance with this, and in order to minimise the risk to investments, the Council has set the minimum acceptable credit quality of counterparties for inclusion on the lending list. As at present, if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately and any existing investment will be matured at the earliest possible convenience.

7.29 For the financial institution sector, the Council will invest in entities with a minimum credit as set out above (A-/A3/A- for a UK bank, and A/A2/A for a non-UK bank as appropriate), as long as that entity has a short term rating F2/P-2/A-3 or better. Where a split rating applies the lowest rating will be used. This methodology excludes banks with UK Government ownership. Banks would need to be rated by at least two of the three main credit rating agencies and where there was a split rating the lower rating would be used.

7.30 The limits can change if there are rating changes, however the maximum limit would never be more than £70 million. Officers are likely to work well within these limits to ensure headroom for short term liquidity.

Country Limits

7.31 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ / Aa1 / AA+ from S&P / Moodys / Fitch (respectively). This criteria applies to countries other than the UK.

8. BORROWING STRATEGY

8.1 The Council has a debt strategy of no new borrowing and where borrowing has fallen due for repayment it has not been replaced. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with borrowing, as cash balances and cash flow has been used as a temporary measure instead. This strategy is prudent as investment returns are low and counterparty risk is high.

8.2 Under the regulatory requirement, there are three borrowing related treasury activity limits. The purpose of these are to monitor and control the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

8.3 The tables below sets out these treasury indicators and limits. The Council is currently compliant with all these indicators. The Council's existing level of fixed interest rate exposure is 100.0% and variable rate exposure is 0.0%.

Interest Rate Exposure for borrowing

£m / %	**2014/15**		**2015/16**		**2016/17**	
Upper Gross Borrowing Limits on fixed interest rates	320	100%	320	100%	320	100%
Upper Gross Borrowing Limits on variable interest rates	64	20%	64	20%	64	20%

Structure limits for debt maturity

Maturity structure of fixed rate borrowing during 2014/15	**Upper Limit**	**Lower Limit**	**Actual Limits as at 31 March 2013**
Under 12 months	15%	0%	4.4%
12 months and within 24 months	15%	0%	1.1%
24 months and within 5 years	60%	0%	11.5%

5 years and within 10 years	75%	0%	9.8%
10 years and above	100%	0%	73.2%

9. POLICY ON BORROWING IN ADVANCE OF NEED

9.1 Under CIPFA's Prudential Code, any decision to borrow in advance of need has to be:

- Within forward approved Capital Financing Requirement (CFR) estimates.
- Would have to be considered carefully to ensure that value for money can be demonstrated;
- And that the Council can ensure the security of such funds.

10. PRUDENTIAL INDICATORS FOR TO BORROWING ACTIVITY

10.1 The Prudential Code requires that the Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators, for the next three years ensuring the capital investment plans are affordable, prudent and sustainable.

10.2 The Authorised Limit for external borrowing. A control on the maximum level of borrowing and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

Authorised Limit

£m	2012/13 Actual	2013/14	2014/15	2015/16	2016/17
Borrowing	325	325	325	325	325
Other long term liabilities	20	20	20	20	20
Total	**345**	**345**	**335**	**335**	**335**

10.3 The Operational Boundary. Is the focus of day to day treasury management activity within the authority and is set at £55m below authorised limit for borrowing. It is a means by which the Council manages its external debt to ensure that it remains within the self imposed Authorised Limit. Sustained breaches of the Operational Boundary would give an indication that the Authority may be in danger of stepping beyond the Prudential Indicators it set itself.

Operational Boundary

£m	2012/13 Actual	2013/14	2014/15	2015/16	2016/17
Borrowing	275	275	275	275	275
Other long term liabilities	13	15	15	15	15
Total	**288**	**290**	**290**	**290**	**290**

10.4 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime, as set by CLG. This is set out in the table above, and declines due to the repayment of the current borrowing as and when it falls due.

10.5 The Executive Director of Finance and Corporate Governance reports that the Council complied with the prudential indicators in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

11. DEBT RESCHEDULING

11.1 Consideration will be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

11.2 However, these savings will need to be considered in the light of the current treasury position and premia incurred in prematurely repaying debt. Given the current approach, Officers monitor the situation continually for an opportunity to repay voluntary any debt. The reasons for any rescheduling to take place will include:

- Generating cash savings.
- Enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

12. HOUSING REVENUE ACCOUNT

12.1 There are to be no changes to the current arrangements regarding debt and the HRA. The separate HRA and General Fund debt pool established from 1 April 2012 will continue to operate. The HRA shall continue to receive investment income on unapplied HRA receipts and other HRA cash balances calculated at the average rate of interest earned on temporary investments.

13. INVESTMENT TRAINING

13.1 The Council is a member of the CIPFA treasury management network which provides a forum for the exchange of views of treasury management staff independent of the treasury management consultants.

13.2 Officers attend the CIPFA network and other providers meetings on a regular basis throughout the year to ensure that they are up to date at all times on developments in treasury management and continue to develop their expertise in this area.

14. GOVERNANCE

14.1 The revised CIPFA Treasury Management Code (2011) requires the Council to outline a scheme of delegation thereby delegating the role of scrutiny of treasury management strategy and policy to a specific named body. In this way treasury management performance and policy setting will be subject to proper scrutiny. The Code also requires that members are provided adequate skills and training to effectively discharge this function.

14.2 The role of the Section 151 officer is delegated to the Executive Director of Finance and Corporate Governance (the S151 Officer), pursuant to Section 101 of the Local Government Act 1972 and by the Executive under Section 15 of the Local Government Act 2000.

14.3 The S151 Officer may authorise officers to exercise on their behalf, functions delegated to them. Any decisions taken under this authority shall remain the responsibility of the S151 Officer and must be taken within the guidelines of the Treasury Management Strategy.

14.4 The S151 Officers has full delegated powers from the Council and is responsible for the following activities:

- Investment management arrangements and strategy;
- Borrowing and debt strategy;
- Monitoring investment activity and performance;
- Overseeing administrative activities;
- Ensuring compliance with relevant laws and regulations;
- Provision of guidance to officers and members in exercising delegated powers.

Monitoring and Reporting

14.5 The Treasury Management activities during the year will be included in the monitoring reports to the Audit, Pensions and Standards Committee.

14.6 The Council's Treasury Management Strategy will be approved annually by full Council and there will also be a mid-year report. The aim of these reporting arrangements is to ensure that those with the responsibility for treasury management policies and activities and those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting. The Council will adopt the following reporting arrangements in accordance with the requirements of the revised code:

Area of Responsibility	**Council / Committee / Officer**	**Frequency**
Treasury Management Strategy	Full Council	Annually, at meeting before the start of the financial year.
Scrutiny of Treasury Management Strategy	Audit, Pensions and Standards Committee	Annually
Treasury Management Strategy: Mid-year report	Audit, Pensions and Standards Committee	Annually, after the first half of the financial year
Treasury Management Strategy: Updates / revisions at other times	1. Audit, Pensions and Standards Committee 2. Full Council	As and when required
Treasury Out-turn Report	1. Audit, Pensions and Standards Committee 2. Full Council	Annually, after year-end
Treasury Management Monitoring Reports	Executive Director of Finance and Corporate Governance	Monthly

15. FINANCIAL AND RESOURCE IMPLICATIONS

15.1 The comments of the Executive Director of Finance and Corporate Governance are contained within this report.

16. LEGAL IMPLICATIONS

16.1 The statutory requirements are set out in the body of the report.

17. COMMENTS OF THE AUDIT, PENSIONS AND STANDARDS COMMITTEE

17.1 Any comments from the Committee will be reported verbally at the meeting.

LOCAL GOVERNMENT ACT 2000
LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
1.	Financial monitoring documents & Capital Programme 2014/18 report	Jade Cheung ext 3374	Finance Department, 2nd Floor, HTH Extension
2.	Treasury Management Strategy 2012/13 (Approved by Full Council February 2013)	Halfield Jackman Tel: 0207 641 4354	Tri-Borough Treasury and Pensions, WCC City Hall

APPENDIX A

THE TREASURY MANAGEMENT POLICY STATEMENT

The CIPFA recommendations contained in the Code of Practice and Cross-Sectoral Guidance Notes issued as a revised version in 2009 and 2011 for Treasury Management in the Public Services require that each Local Authority has a Treasury Management Policy Statement that is approved by the Full Council.

CIPFA recommends that the Council's treasury management policy statement adopts the following form of words below to define the policies and objectives of its treasury management activities.

This 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 comprehensive performance.

APPENDIX B

UK T-Bills: UK Government Treasury Bills (T-Bills) are short term promissory notes issued by the UK Government at a discount to par, for tenors of up to one year. T-Bills provide a greater yield than cash deposits with the DMO and can be bought at the primary sale (by market makers), or in the secondary market.

UK Gilts: UK Government Gilts provide a greater yield than cash deposits with the DMO. At present, there are a limited number of gilts that will mature in the next two years, and as the shorter dated gilts were issued in a higher interest rate environment than at present, the coupons on these gilts are higher than current interest rates.

UK Government repurchase agreements (Repos): UK Government repurchase agreements are the purchase of UK Government securities with an agreement to resell them back at a higher price at a specific future date. By their nature, repos are short term secured investments in UK Government bonds which provide a greater return than cash deposits with the DMO. Ownership of the UK Government bond is temporarily transferred to the Council, thereby providing security over the funds invested.

Commercial Paper (CP) is similar to a very short term bond issue (up to one year), issued to investors on a discounted basis, and with the interest rate based on prevailing rates at the time of pricing. The Council may invest in Commercial Paper issued by UK domiciled corporate subject to the minimum credit ratings for up to a maximum of six months with no more than £15 million per name, and £90 million in aggregate.

Supra-national institutions are those that sovereign backed or supported institutions that span more than one country, such as the European Investment Bank, the European Bank of Reconstruction and Development, the World Bank, etc.

Network Rail: All Network Rail infrastructure debt is directly and explicitly backed by a financial indemnity from the Secretary of State for Transport acting for and on behalf of the government of the United Kingdom of Great Britain. The financial indemnity is a direct UK sovereign obligation of the crown and cannot be cancelled for any reason (prior to its termination date in October 2052). Propose to change TMS limit to unlimited and set the maximum maturity to Oct 2052.

APPENDIX C

CREDIT RATING AGENCY NOMENCLATURE

Long term ratings	**Fitch**	**Moody's**	**S&P**
Investment Grade Focuses on liquidity and ability to meet payment obligations on time	AAA	Aaa	AAA
	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
	A+	A1	A+
	A	A2	A
	A-	A3	A-
	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
Non-investment grade (junk) Focus on recovery percentage in the event of partial or total default	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-
	CCC	Caa	CCC
	CC	Ca	CC
	C	C	C
	D		D

Short term ratings	**Fitch**	**Moody's**	**S&P**
Investment Grade	F1+	Prime-1	A-1+
	F1	Prime-2	A-1
	F2	Prime-3	A-2
	F3		A-3
Non-investment grade	B	Not Prime	B
	C		C
	D		D

APPENDIX D
Money Market Funds and Enhanced Money Funds

A Money Market Fund (MMF) is a pooled investment vehicle which is provides liquidity, stability of capital and typically offers a better yield than a traditional bank deposit. MMFs invest in a variety of high quality, short dated cash instruments (for example certificates of deposit, time deposits, call deposits, commercial paper).

An Enhanced Money Fund (EMF) is a pooled investment vehicle that invests in a wider variety of assets than an MMF. EMFs are permitted to hold longer dated assets and as a result they are not as liquid and are aim to attract a higher return than MMFs.

Both funds offer asset diversification and are managed by fund managers with specialist fund management skills.

Both funds can use two methods to value their assets; constant net asset value (CNAV) or variable net asset value (VNAV) or a combination of both. The principal difference is the accounting technique used to value the assets:

- Amortised cost accounting which values the asset at its purchase price, and then subtracts the premium / adds back the discount in a regular fashion (linearly) over the life of the asset. The asset will then be valued at par (100) at its maturity. This enables the funds to maintain a net asset value (NAV), or value of a share of the fund at £1. This is the CNAV approach typically adopted by MMFs funds.

- Mark-to-market accounting values the assets at market price. The NAV of a fund that uses this form of accounting will change due to the changing value of the assets or in the case of accumulating funds (where any interest is capitalised back into the fund instead of being paid out as an income) by the amount of interest earned. This is the VNAV approach usually adopted by EMFs which have a constantly varying share price. In practice the fund manager will aim to maintain the share price above £1 and ensure a smooth gradual increase in price on a daily basis.

MMFs tend to pay out monthly dividends to investors whereas the EMFs tend to reinvest dividends back into the fund.

MMFs funds are marketed as an instant access investment where funds can be invested and removed on a daily basis therefore forming part of the council operational cash pool.

EMFs tend to marketed as a longer term investment that offers an enhanced return over the MMFs. Investments should therefore only be invested as part of a longer term investment plan.

At present, the Council invests in several AAA-rated sterling MMFs. The Council will only invest in funds that comply with the criteria agreed by the Executive Director of Finance and Corporate Governance and the Leader of the Council.