London Borough of Hammersmith & Fulham **CABINET** **8 FEBRUARY 2016**	
TREASURY MANAGEMENT STRATEGY REPORT 2016/17	
Report of the Cabinet Member for Finance – Councillor Max Schmid	
Open Report	
Classification - For Decision **Key Decision: Yes**	
Wards Affected: ALL	
Accountable Executive Director: Hitesh Jolapara, Strategic Finance Director	
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1. EXECUTIVE SUMMARY

1.1 The report sets out the Council's Treasury Management Strategy for 2016/17. It seeks approval for the Strategic Finance Director to arrange the Treasury Management Strategy in 2016/17 as set out in this report.

2. RECOMMENDATIONS

2.1 That approval be given to the future borrowing and investment strategies as outlined in this report and that the Strategic Finance Director be authorised to arrange the Council's cash flow, borrowing and investments in 2016/17.

2.2 In relation to the Council's overall borrowing for the financial year, to note the comments and the Prudential Indicators as set out in this report and the four year capital programme 2016/17 to 2019/20.

2.3 That approval be given to pay the Housing Revenue Account (HRA) investment income on unapplied HRA receipts and other HRA cash balances calculated at the average rate of interest (approximately 0.60% p.a.) earned on temporary investments throughout the year with effect from 1 April 2015.

3. BACKGROUND

3.1 The Council is required to set a balanced budget, which means that income raised during the year is budgeted meet expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

3.2 The second main function of the treasury management service is the funding of the Council's capital plans. These plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3.3 CIPFA[1] defines treasury management 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."

3.4 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 Finance and Delivery PAC.

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

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

3.6 Section 6 of this report sets out the investment approach, and takes account of the specified and non-specified[2] approach. The Council is likely only to consider non-specified investments where an investment is made for longer than one year.

3.7 The CIPFA recommendations contained in the Code of Practice and Cross-Sectoral Guidance Notes issued as a revised version in 2011 for Treasury

[1] Chartered institute of Public Finance and Accountancy
[2] Specified and non-specified investments are defined in Section 6.19 and 6.20

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.

4. PROSPECTS FOR INTEREST RATES

4.1 The current economic outlook and structure of market rates and government debt yields have several key treasury management implications:

4.2 The Council's treasury advisors are Capita Asset Services and part of their service is to assist the Council to formulate a view on future interest rates. The table below gives their view.

Interest Rate Forecast

Future Date	Forecast Bank Rate %	PWLB Borrowing Rates % (including the certainty rate adjustment)			
		5 Year	10 Year	25 Year	50 Year
December 2015	0.50	2.30	2.90	3.60	3.50
March 2016	0.50	2.40	3.00	3.70	3.60
June 2016	0.75	2.60	3.10	3.80	3.70
September 2016	0.75	2.70	3.20	3.90	3.80
December 2016	1.00	2.80	3.30	4.00	3.90
March 2017	1.00	2.80	3.40	4.10	4.00
June 2017	1.25	2.90	3.50	4.10	4.00
September 2017	1.50	3.00	3.60	4.20	4.10
December 2017	1.50	3.20	3.70	4.30	4.20
March 2018	1.75	3.30	3.80	4.30	4.20
June 2018	1.75	3.40	3.90	4.40	4.30
September 2018	2.00	3.50	4.00	4.40	4.30
December 2018	2.00	3.50	4.10	4.40	4.30
March 2019	2.00	3.60	4.10	4.50	4.40

Source: Capita Interest rate forecast as at 11 Nov 2015

4.3 The November Bank of England Inflation Report included a forecast for growth to remain around 2% over the next three years, driven mainly by strong consumer demand.

There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing the Bank Rate.

4.4 The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 1.5% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its

September meeting to pull back from a first rate increase. However, the non-farm payrolls[3] figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now firmly opened up the possibility of a first rate rise in December.

In January the European Central Bank (ECB) started a €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EuroZone (EZ) countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

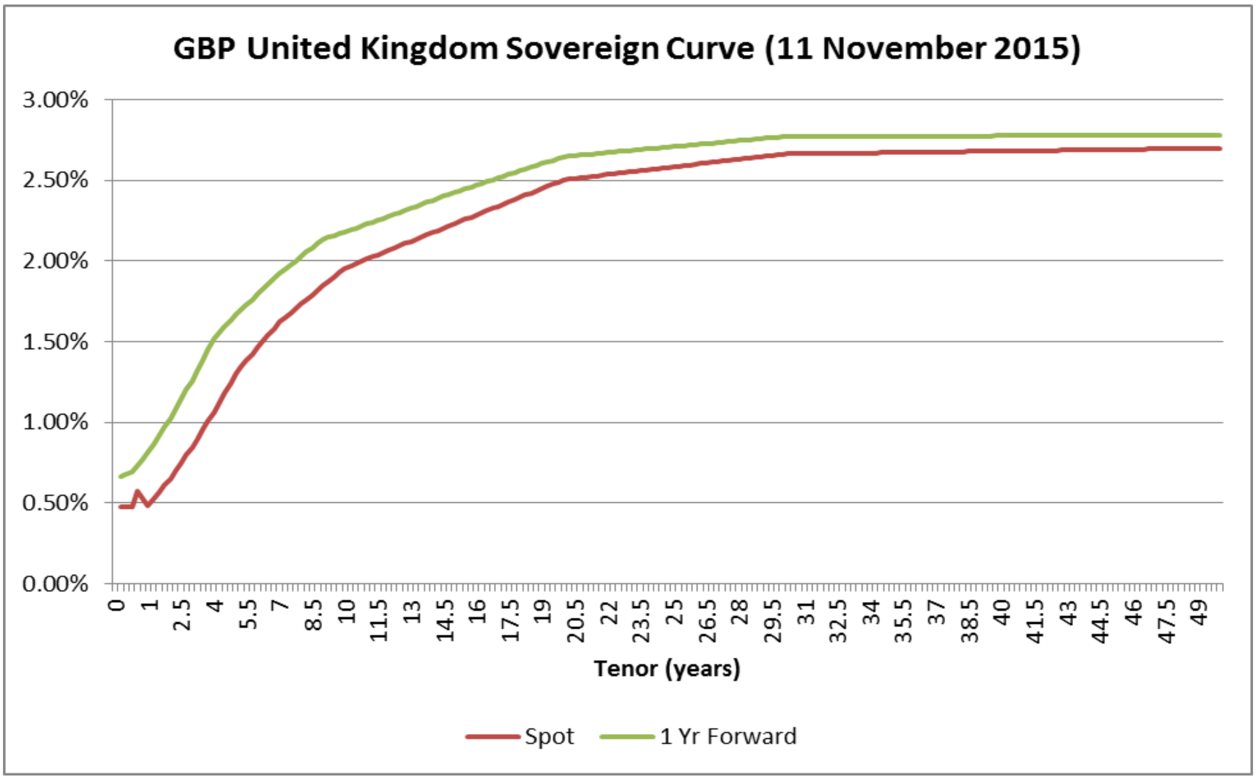
4.6 Investment returns are likely to remain relatively low during 2015/16 and beyond;

Borrowing interest rates have been volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years and this will be kept under review.

There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

The graph below shows the current Gilt rates and those projected (by investors) in a year's time. It is apparent, an increase in interest rates across all maturities is expected – though a limited increase rather than a material change. It should be noted that this has been the case for the last 3 or 4 years.

[3] The US Bureau of Labor Statistics which represents the total number of paid US workers of any business (excluding general government employees and private household employees



Source: Bloomberg as at 17 Nov 2015

5. CURRENT TREASURY POSITION

5.1 At the 20th January 2016, the Council had £348 million cash investments. The cash is made up of the Council's usable reserves, capital receipts and unspent government grants. The level of cash has remained broadly at the same level as the start of the financial year, and it is anticipated the cash levels at the end the financial year will be approximately £330 - £350 million.

5.2 The Capital Financing Requirement (CFR) is stated below with and without schools' windows in the table below. This is because the Dedicated Schools Grant (DSG) will compensate the council for any cost of borrowing associated with the Schools' Windows programme.The forecast closing General Fund debt as measured by the CFR for 2015/16 is £44.26m. This is subject to the application of forecast capital receipt surpluses to debt reduction at the year-end. The CFR with the DSG-funded Schools Windows will be £45.26m.

Forecast Movement in the General Fund Capital Financing Requirement (CFR) [4]

£m	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Closing Capital Finance Requirement (Including DSG-funded Schools Windows borrowing)	**45.26**	**52.51**	**57.21**	**58.54**	**59.57**
Closing Capital Finance Requirement (Excluding DSG-funded Schools Windows borrowing)	**44.26**	**42.17**	**37.92**	**39.79**	**41.61**

[4] It should be noted that because of the timing of the report process the CFR figures will change before reaching Full Council in February 2016.

5.3 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.

5.4 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 financed 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.

5.5 There are 5 Prudential Indicators for 2015/16 relating to capital stated in the Capital Programme 2015/16 to 2019/20 report to Budget Council in February 2016, (to meet CIPFA's Prudential Code requirements).

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

Current Portfolio Position

£'000	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Borrowing at 1 April	250,511	247,599	231,897	224,822	217,405	212,841
Expected change in borrowing during the year	(2,912)	(15,703)	(7,074)	(7,418)	(4,564)	(5,705)
Actual Borrowing at 31 March	247,599	231,897	224,822	217,405	212,841	207,136
Total investments at 31 March	(360,000)	(350,000)	(330,000)	(300,000)	(300,000)	(300,000)
Net borrowing/(investment)	(112,401)	(118,103)	(105,177)	(82,595)	(87,159)	(92,864)

Split between the Housing Revenue Account and General Fund: External borrowing (PWLB) position at Year End

£'000 External Borrowing only	2015/16	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Housing Revenue A/c (HRA)	192,283	186,417	180,266	176,482	171,752
General Fund (GF)	39,614	38,406	37,139	36,359	35,384
Total borrowing at year end	231,897	224,823	217,405	212,841	207,136

Sets out the Closing Capital Financing Requirement analysed between General Fund and Housing Revenue Account.

Closing CFR only £'000	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
GF CFR (Excluding DSG funded Schools Windows Borrowing)	44,260	42,167	37,919	39,788	41,613
GF CFR (DSG funded Schools Windows borrowing)	1,000	10,340	19,295	18,755	17,955
HRA CFR	210,009	221,483	235,856	254,617	254,617
TOTAL CFR	**255,269**	**273,990**	**293,070**	**313,160**	**314,185**

6. ANNUAL INVESTMENT STRATEGY

6.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a rating 'uplift' due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed.

6.2 It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into rating through the financial crisis. In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses on the Short and Long Term ratings of an institution as well as Credit Default Swaps[5] (CDS).

6.3 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, the Council typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA+. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

Investment Policy

6.4 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

[5] Credit ratings are based on historical information and Credit Default Swaps (CDS) reflect current market sentiment if the CDS value raises significantly over a short period this could be an early warning of possible changes in credit rating and trigger further investigation. (see Appendix C for a definition)

6.5 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

6.6 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

6.7 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

6.8 This section sets out the Council’s annual investment strategy for 2016/17 and any proposed changes from the 2015/16 Treasury Management Strategy, the table overleaf 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.

Institution Type	Minimum Long Term Credit Rating Required 2016/17 (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit 2016/17 (£m)	Maximum tenor of deposit / investment 2016/17	Changes from the 2015/16 Strategy
DMO Deposits	UK Government Rating AA+	Unlimited	6 months	No change
UK Government (Gilts / T-Bills / Repos)	UK Government Rating AA+	Unlimited	Unlimited	No change
Supra–national Banks	AA- / Aa3 / AA-	£100m	5 years	No change
European Agencies	AA- / Aa3 / AA-	£100m	5 year	No change
Network Rail	UK Government Rating	£200m	Oct 2052	No change
TFL	AA- / Aa3 / AA-	£100m	3 years	No change
GLA	N/A	£100m	3 years	No change
UK Local Authorities	N/A	£10m per Local Authority, £50m in aggregate	1 years	No change
Commercial Paper issued in sterling by UK and European corporate	Long Term AA- / Aa3 / AA- Short Term F2/ P-2 /A-3	£20m per name, £80m in aggregate	1 year	Six months
Covered Bonds issued in sterling by UK and European corporate	AA+/Aa1/AA+ The bond issue; Investment grade of underlying assets	£100m	5 years	A move from the credit rating of the issuer to the underlying assets
Money Market Funds MMF	AAA by at least one of the credit agencies	£30m per fund manager, £200m in aggregate	Up to three day notice	£25m per fund manager
Enhanced Money Funds	AAA by at least one of the credit agencies	£20m per fund manager, £60m in aggregate	Up to seven day notice	No change
UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	AA- / Aa3 / AA- and above (or UK Government ownership of greater than 25%) Short Term F2/ P-2 /A-3	£70m	5 years	No change
UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	Long Term A-/ A3 / A- Short Term F2/ P-2 /A-3	£50m	3 years	No change

Institution Type	Minimum Long Term Credit Rating Required 2016/17 (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit 2016/17 (£m)	Maximum tenor of deposit / investment 2016/17	Changes from the 2015/16 Strategy
Non-UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	Long term AA- / Aa2 / AA- Short Term F2/ P-2 /A-3	£50m	3 years	No change
Non-UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	Long Term A / A2 / A Short Term F2/ P-2 /A-3	£30m	1 year	No change

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

- Current investment types
- Proposed changes to investment limits and tenors
- Non-specified investments
- Creditworthiness criteria
- Country limits.
- Potential Alternative Investments

Current Investment Types[6]

6.10 As per the 2015/16 Treasury Management Strategy, it is proposed that for 2016/17 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)

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

(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)

[6] Appendix B provides more detail on the various asset classes.

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

(vii) Investment in Supra-national Banks/European Agencies AA- rated issuer bonds and commercial paper;

(viii) Investment in AAA-rated Sterling Money Market Funds and Enhanced Money Funds.

(ix) Investment in commercial paper (CP) of UK domiciled entities with minimum short term credit rating of A3/P-2/F-2.

Certificates of Deposit

6.11 Financial institutions as well as offering loans, also borrow through the issuance of Certificates of Deposit (CD). These are tradable instruments where the issuer borrows at a set rate for an agreed length of time, before repaying the principal at maturity. CD's tend to have a shorter length tenors, unlike bonds, and enable an investor to manage more actively any credit/ counterparty exposure, rather than waiting for a fixed term deposit to mature.

6.12 In determining whether to place deposits with any institution or fund, the Treasury Manager 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:

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

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

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

(xiii) Core Tier 1 capital ratios; and

(xiv) other external views as necessary.

6.13 The investments portfolio has remained around £350 million throughout the year to date. The shape of the current yield curve, the likely low level of interest rates for the immediate future and the opportunities for investment, it is proposed that limits and tenors of investment also remains at the same for the majority of investment types.

6.14 Officers took advantage of last year's TMS changes to invest in longer dated maturities and as a result gained an additional 10 basis points (0.50% to 60%) or 20% yield up lift on last year.

6.15 The graph in paragraph 4 above shows a steep current and one-year forward yield curve, and that higher returns for tenors up to five years (for a core level of cash) would provide greater returns rather than a shorter investment. Given the predicted rise in interest rates however, the Council while wanting to take advantage of higher rates for longer duration investments will also want to benefit from a rise in rates when they occur rather than locked in to then lower yielding investments.

6.16 In summary, the bank investment limits are shown in the table below (no change).

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment
UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	AA- / Aa3 / AA- and above (or UK Government ownership of greater than 25%) Short Term F2/ P-2 /A-3	70	No change
UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	Long Term A-/ A3 / A- Short Term F2/ P-2 /A-3	50	No change
Non-UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	Long term AA- / Aa2 / AA- Short Term F2/ P-2 /A-3	50	No change
Non-UK Bank Fixed Deposits / Certificates of Deposit / Short Dated Bonds	Long Term A / A2 / A Short Term F2/ P-2 /A-3	30	No change

Proposed changes to investment limits and tenors

Covered Bonds

6.17 Covered bonds are debt instruments issued by a financial institution, but where security has been granted over a pool of underlying assets (e.g. a pool of mortgage loan or public sector debt) to which investors have a preferential claim in the event of default. The covered bond issue would be rated by the rating agencies, and while the issuer would be allowed to ‘swap’ some of the underlying collateral, it is up to an independent custodian / agent to validate that what is being taken out of the pool is of no worse status than that being switched in. the issuance of covered bonds enables financial institutions to obtain lower funding in order grant mortgage loans for housing and non-residential property as well as to finance public debt.

It is proposed that this asset class is changed to reflect the credit rating of the underlying assets and not the issuer. In the unlikely event that a covered bond defaulted an investor has dual recourse to the underlying issuer as well as the pool of collateral. This would enable the Council to investment in AAA rated assets at a favourable rates (Appendix F).

6.18 The current MMF’s limit is £25 million per fund (£200 million aggregate) and it is proposed that it is raised to £30 million per fund £200 million for MMFs the limit this would increase the level of liquidity available. EMFs will stay at £20 million (£60 million aggregate).

Non-specified investments

6.19 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.

6.20 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 Strategic Finance Director on the recommendation from the 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.

6.21 Long term investments (for periods over 364 days) will be limited to no more than £120 million with a tenor of up to five year.

Creditworthiness Criteria

6.22 As has been the case for 2015/16, 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.

6.23 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, any further use will be stopped immediately and any existing investments will be matured at the earliest possible convenience.

6.24 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.

6.25 The limits can change if there are rating changes, however the maximum limit would never be more than specified by institution type in paragraph 6.8. Officers are likely to work well within these limits to ensure headroom for short term liquidity.

Country Limits

6.26 The current TMS is based on a ratings approach to country of domicile, for 2016/17, it is proposed that deposits / investments are made with financial entities domiciled only in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, UK and USA (see Appendix E).

7. BORROWING STRATEGY

7.1 The Council is currently maintaining an under-borrowed (internal borrowing) position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's Reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

7.2 The HRA will fund its requirements from additional internal borrowing. The General Fund has no expectation of borrowing in the near future.

7.3 Against this background and the investment risks described in this paper, caution will be adopted with the 2016/17 treasury operations. The treasury team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances and advise the Strategic Finance Director accordingly.

7.4 If there was a significant risk of a much sharper rise in long and short term rates than the currently forecast. Then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower then they will be in the next few years.

7.5 The General Fund 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. HRA's funding requirements differ from the General Fund's and external borrowing in the HRA may be required in 2016/17 as a result of the rent reduction, 1% each year for the next four years, imposed by Government in July 2015.

7.6 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.

7.7 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 / %	2016/17		2017/18		2018/19	
Upper Gross Borrowing Limits on fixed interest rates	385	100%	385	100%	385	100%
Upper Gross Borrowing Limits on variable interest rates	77	20%	77	20%	77	20%

Structure limits for debt maturity

Maturity structure of fixed rate borrowing during 2015/16	Upper Limit	Lower Limit	Actual Limits as at 30 September 2015
Under 12 months	15%	0%	5.0%
12 months and within 24 months	15%	0%	3.7%
24 months and within 5 years	60%	0%	7.1%
5 years and within 10 years	75%	0%	13.0%
10 years and above	100%	0%	71.2%

8. POLICY ON BORROWING IN ADVANCE OF NEED

8.1 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.

9. PRUDENTIAL INDICATORS FOR TO BORROWING ACTIVITY

9.1 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.

9.2 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	**2014/15 Actual**	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Borrowing	325	325	325	325	325	325
Other long term liabilities	20	20	20	20	20	20
Total	**345**	**345**	**345**	**345**	**345**	**345**

9.3 The Operational Boundary is the focus of day to day treasury management activity within the authority and is set at £50m 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	**2014/15 Actual**	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Borrowing	275	275	275	275	275	275
Other long term liabilities	15	15	15	15	15	15
Total	**288**	**290**	**290**	**290**	**290**	**290**

9.4 The HRA CFR is required to remain within a 'Debt Cap' as set by the Department for Communities and Local Government as part of the transition to HRA self-financing. The Council's debt cap is currently set at £254.62m.

9.5 The Strategic Finance Director 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.

10. DEBT RESCHEDULING

10.1 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.

10.2 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).

11. HOUSING REVENUE ACCOUNT

11.1 For the period 2016/17 – 2019/20, based on the planned four year capital programme and other sources of capital resources, borrowing will be funded principally from internal resources.

11.2 The availability of internal borrowing is achieved through the use of monies received classed as capital receipts. Use of this money is classed as borrowing as although cash is received from developers on a phased basis, receipts are only deemed usable for funding purposes as assets transfer to the purchaser. This does not prevent the Council from spending the cash it receives, but until such time that assets transfer any such use is classed as borrowing. This borrowing unwinds when the receipt becomes usable. The total available to the HRA for the purposes of internal borrowing is the difference between the HRA CFR and the external borrowing in each year. This is shown in the table in paragraph 5.6 above.

11.3 Full details of the Housing Revenue Account's likely borrowing requirements is set out in the Long Term Financial Plan for Council Homes which is also being presented to Cabinet on the 8th February 2016.

12. TRAINING

12.1 The CIPFA Code requires the lead officer to ensure that Members with Treasury Management responsibilities receive adequate training in Treasury Management. This especially applies to Members responsible for scrutiny. Members will be offered training and arrangements will be made as required.

12.2 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. 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.

12.3 The training needs of the Treasury Management team are periodically reviewed.

13. GOVERNANCE

13.1 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 (Audit, Pensions and Standards Committee). 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.

13.2 The role of the Section 151 officer is delegated to the Strategic Director of Finance (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.

13.3 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.

13.4 The S151 Officer 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

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

13.6 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	1. Audit, Pensions and Standards Committee 2. Finance and Delivery PAC	Annually, after the first half of the financial year
Treasury Management	1. Audit, Pensions and	As and when required

Strategy: Updates / revisions at other times	Standards Committee 2. Finance and Delivery PAC 3. Full Council	
Treasury Out-turn Report	1. Audit, Pensions and Standards Committee 2. Finance and Delivery PAC 3. Full Council	Annually, after year-end
Treasury Management Monitoring Reports	Director for Finance	Monthly

14. FINANCIAL AND RESOURCE IMPLICATIONS

14.1 The comments of the Strategic Director of Financial Services are contained within this report.

14.2 This report is wholly of a financial nature.

15. LEGAL IMPLICATIONS

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

15.2 Implications verified by: Rhian Davies, Chief Solicitor, Shared Legal Services, 0207 641 2729.

16. COMMENTS OF THE AUDIT, PENSIONS AND STANDARDS COMMITTEE

16.1 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.	Capital Programme Monitor & Budget Variations 2015/16 (2nd Quarter) report – published	Christopher Harris Tel: 0208 753 6440	Finance Department, 2nd Floor, HTH Extension
2.	Treasury Management Strategy 2015/16 (Approved by Full Council February 2015) - published	Halfield Jackman Tel: 0207 641 4354	Shared 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.

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

A Credit Default Swap (CDS) is a contract between two counterparties in which the buyer of the contract makes quarterly payments to the seller of the contract in exchange for a payoff if there is a credit event of the reference entity. The reference entity is the third party on whom the contract is based. A credit event depends on the Doc Clause (terms and conditions) of the CDS agreement but this usually includes events such as default on coupon payments, restructuring of debt, bankruptcy etc.

The contract essentially gives protection, or “insurance”, to the buyer of the CDS in the case of a credit event of the reference entity. As the CDS market is currently unregulated, it cannot technically be seen as insurance as the seller of the contract does not have to set aside any reserves for any possible future credit event.

As with all swap contracts, a CDS has 2 legs: a fee leg and a contingent leg. The fee leg of the CDS is the leg in which the buyer of the protection pays quarterly payments to the seller. The contingent leg of the CDS is the leg in which the seller of the CDS pays the buyer if a credit event occurs.

The fee leg payments are based on the spread currently traded in the market. The spread of a CDS indicates the market perception of the likelihood of a credit event occurring.

The higher the spread, the higher the cost of protecting against a credit event, the more likely the market considers a credit event will occur. The spread can be likened to an insurance premium paid on.

APPENDIX D

CREDIT RATINGS

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 E:

Approved countries for investments

November 2015

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- Netherlands
- UK
- USA

APPENDIX F

Indicative rates (October 2015)

Covered fixed	Coupon	Maturity date	Moody's/S&P/Fitch	Yield	ISIN
Bank of Scotland plc	4.88%	08/11/2016	Aaa/AAA	0.97%	XS0274407039
Yorkshire Building Society	4.75%	12/04/2018	Aaa/AAA	1.20%	XS0616210752
Coventry Building Society	4.63%	19/04/2018	Aaa/AAA	1.20%	XS0618833635
Leeds Building Society	4.25%	17/12/2018	Aaa/AAA	1.30%	XS0635000036