Agenda Item:

9b

Cabinet

Dorset County Council

Date of Meeting	11 February 2016
Cabinet Member Robert Gould – Leader of the Council and Cabinet Member for Corporate Resources Lead Officer Richard Bates – Chief Financial Officer	
Subject of Report	**Treasury Management Strategy Statement and Prudential Indicators for 2016-17**
Executive Summary	The CIPFA Prudential Code highlights particular aspects of the planning of capital expenditure and the funding of that expenditure. The Code requires the publication and monitoring of Prudential Indicators which inform Members of the scope and impact of the capital spend. In addition, there are separate requirements under the CIPFA Treasury Management Code to publish a Treasury Management Strategy. This report sets out the issues for consideration and seeks agreement to the required indicators and strategies.
Impact Assessment:	Equalities Impact Assessment: There are no equality issues that arise from this report.
	Use of Evidence: Historical trends and experiences along with professional advice and recommended best practices have been followed in the development of this strategy and the formulation of the Prudential Indicators.
	Budget: All treasury management budget implications are reported as part of the Corporate Budget.

	Risk Assessment: Having considered the risks associated with this decision using the County Council's approved risk management methodology, the level of risk has been identified as: Current Risk: MEDIUM Residual Risk MEDIUM Treasury management is an inherently risky area of activity. This report describes those risks and the controls in place to mitigate those risks.
	Other Implications: None.
Recommendation	The Cabinet recommends to the County Council approval of: 1. The Prudential Indicators and Limits for 2016/17 to 2018/19. 2. The Minimum Revenue Provision (MRP) Statement. 3. The Treasury Management Strategy. 4. The Investment Strategy. 5. Delegation to the Chief Financial Officer to determine the most appropriate means of funding the Capital Programme.
Reason for Recommendation	The Prudential Code gives a framework under which the Council's capital finance decisions are carried out. It requires the Council to demonstrate that its capital expenditure plans are affordable, external borrowing is within prudent and sustainable levels and treasury management decisions are taken in accordance with professional good practice. Adherence to the Prudential Code is mandatory as set out in the Local Government Act 2003. This report recommends the indicators to be applied by the Council for the financial years 2016/17 to 2018/19. The successful implementation of the code will assist in our objective of developing 'public services fit for the future'.
Appendices	1. Treasury Management Investment Policy and Annexes 2. Schedule of Delegations
Background Papers	CIPFA Treasury Management Code of Practice Local Government Finance Settlement 2016/17 CIPFA Prudential Code for Capital Finance in Local Authorities
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1. Background

1.1. The Treasury Management function of the Council manages the cashflow, banking, money market transactions and long term debts, and in doing so manages the risks associated with these activities with a view to optimising interest earned and minimising the costs of borrowing. The cash turnover of the Council from day to day activities is approximately £1,500m a year; with roughly £750m a year cash income and £750m cash expenditure, reflecting the fact that the Council is required to set a balanced budget. These large sums of monetary activity mean that Treasury operations within Local Government are highly regulated.

1.2. The Local Government Act 2003 introduced greater freedoms for Councils in relation to capital investment and the powers to borrow to finance capital works. To ensure that Councils use these powers responsibly, the Act requires the Council to adopt the CIPFA Prudential Code and adhere to annually produced Prudential Indicators. The underlying objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with the best professional practice. There are prudential indicators which summarise the expected capital activity and apply limits upon that activity and as a result the levels and types of borrowing. They reflect the outcome of the Council's underlying capital appraisal systems.

1.3. Within this prudential framework there is an impact on the Council's treasury management activity, as it directly impacts on its borrowing and investment activities. As a consequence the treasury management strategy is included as part of this report to complement these indicators.

1.4. This report revises the previously approved prudential indicators for 2016/17 and 2017/18, adds an extra year for 2018/19, and sets out the expected treasury operations for the next three year period. It fulfils four key legislative requirements:

a. The reporting of the prudential indicators setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities);

b. The setting of the Council's Minimum Revenue Provision (MRP) Policy, which states how the Council will repay the borrowing made to fund capital purchases through the revenue account each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007, and in accordance with CLG Guidance);

c. The reporting of the Treasury Management Strategy Statement which sets out how the Council's treasury function will support the capital programme decisions, day to day treasury management and the restrictions on activity set through the treasury prudential indicators. The key indicators are required as part of the Local Government Act 2003 and is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code.

d. The reporting of the investment strategy which sets out the Council's criteria for choosing investment counterparties and how it minimises the risks faced. This strategy is in accordance with the CLG Investment Guidance.

1.5. The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

2. Treasury Management Advisers

2.1. The Council uses Capita Asset Services as its treasury management advisers. Capita provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings-market information service comprising the three main credit rating agencies.

2.2. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Council. This service is subject to regular review.

3. Economic Outlook and Prospects for Interest Rates

3.1. Part of Capita's service is to assist the Council to formulate a view on interest rates. The following table gives Capita's forecast for UK base rates and borrowing rates from the Public Works Loans Board (PWLB).

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

3.2. Capita's view of the economic outlook are summarised in the following paragraphs:

3.3. UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation. This is at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

3.4. The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase. However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee (MPC) will decide to make a start on increasing Bank Rate. The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

3.5. The US 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 Federal Reserve's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Federal Reserve that concerns on the international scene have subsided decided to raise interest rates by 0.25% in December 2015, its first increase since 2006.

3.6. In the Eurozone, the European Central Bank (ECB) in January 2015 launched a €1.1 trillion programme of Quantitative Easing (QE) to buy up high credit quality government and other debt of selected Eurozone 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), with +0.4% (+1.5% y/y) in quarter 2 and +0.3% (+1.6% y/y) in quarter 3. This is the fastest pace of expansion in over four years. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it 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%.

3.7. During July, Greece finally capitulated to European Union (EU) demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third rescue package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest rescue package.

3.8. The general elections in Portugal and Spain, in September and December respectively, have opened up new areas of political risk where the previous reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

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

a) Investment returns are likely to remain relatively low during 2016/17 and beyond;
b) Long term 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. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when the Council will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
c) There will remain a cost of carry to any new borrowing which causes an increase in investments, as this will incur a revenue loss caused by high borrowing costs and low investment returns.

4. Capital Programme Prudential Indicators

4.1. The Prudential Indicators (PIs) are driven by the Council's Capital Programme plans. The Capital Programme influences all borrowing decisions made by the Council and the subsequent Treasury Management activity associated with this. The PIs are also influenced by wider Council decisions and the effect of the revenue and capital proposals, included in the reports elsewhere on this agenda. All assumptions in this report are therefore consistent with the Medium Term Financial Plan.

4.2. The corporate criteria for capital investment, as laid out in the Asset Management Plan, were used to establish a list of priority projects for possible inclusion in the forward plan. The capital expenditure figures in 2014/15 and the estimates of capital expenditure to be incurred in the current and future years, that form the basis of the Prudential Indicators, are based on the Capital Programme 2016/17 to 2018/19 report.

Prudential Indicator 1 – Capital Expenditure

4.3. The first requirement of the Prudential Code is that the Authority must make reasonable estimates of the total capital expenditure it intends to incur over the following three financial years. Table 1 illustrates the actual and anticipated level of capital expenditure for the five years 2014/15 to 2018/19 and is the starting point for setting the rest of the PIs. Members will already be familiar with the figures from the quarterly Asset Management Monitoring reports to the Cabinet.

Table 1 – Capital Programme Expenditure 2014/15 to 2018/19

	2014/15 £000 Actual	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate	2018/19 £000 Estimate
Environment	36,715	58,347	28,784	31,526	15,307
Childrens	26,038	29,561	21,941	8,499	3,300
Adult & Community	727	4,053	2,023	2,997	285
Cabnet / Whole Authority	9,837	21,183	12,394	7,239	2,158
Dorset Waste Partnership	6,003	4,702	5,614	1,184	0
Vehicles	1,454	2,571	1,592	1,624	1,656
Structural Maintenance	0	8,311	8,560	7,510	7,510
Contingency & Flexibility	0	2,499	848	0	0
Slippage	0	-40,000	0	20,000	20,000
TOTAL	**80,774**	**91,227**	**81,756**	**80,579**	**50,216**

4.4. The figures appear to show a decline in capital expenditure from 2018/19 onwards. This is because they only include expenditure that can be financed from sources that are reasonably certain at this point in time. Figures for 2017/18 and 2018/19 also include slippage from previous years and funding from already earmarked capital receipts. Assumptions have been made about the likely level of government funding in future years and may therefore require revision.

4.5. The capital expenditure figures assume a certain level of funding from borrowing for each year. Capital expenditure which cannot be immediately financed, or paid for, through revenue or capital resources (such as capital receipts), will require funding through either new borrowing or the utilisation of available cash resources pending borrowing. It is the new borrowing, together with existing borrowing, which has to be prudent, affordable and sustainable which forms the main element of the Prudential Code and drives PIs 2 to 7. Proposals on the level of borrowing for capital purposes are shown at paragraph 7.2 of this report and are set out for approval in the Revenue and Capital reports on this agenda.

Prudential Indicator 2 – The Capital Financing Requirement

4.6. The capital financing requirement (CFR) measures the Authority's underlying need to borrow for capital purposes. This figure includes all long term borrowing as well as financing that is implicit in Private Finance Initiative schemes and finance leases.

4.7. As part of a proactive and efficient Treasury Management Strategy, the Council does not differentiate between cash held for revenue purposes and cash held to fund the capital programme. At any point in time the Council has a number of cash flows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices.

4.8. External borrowing arises from long term funding of capital spend and short term cash management if required, and as such can fluctuate over a number of months and years. In contrast, the capital financing requirement reflects the Council's underlying need to borrow for a capital purpose. The CIPFA Prudential Code includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

4.9. This basically means that the Council can only borrow for capital purposes and only for the capital expenditure it has set out and approved over the course of its three year capital programme. Estimates of the end of year capital financing requirement for the Council for the current and future years and the actual capital financing requirement at 31 March 2015 are:

Table 2 Capital Financing Requirement Actual and Forecast 2014/15 – 2018/19

	2014/15 £000 Actual	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate	2018/19 £000 Estimate
Debt	292,845	295,387	317,893	344,356	359,041
Long Term Liabilities	42,042	38,420	34,798	31,176	27,554
CFR	**334,887**	**333,807**	**352,691**	**375,532**	**386,595**

Prudential Indicator 3 – Ratio of Financing Costs to Net Revenue Stream

4.10. PI 3 expresses the net costs of financing the capital programme as a percentage of the funding receivable from the Government and council tax payers, expressed as a ratio. The net cost of financing includes interest and principal repayments, netted off by interest receivable in respect of any cash investments held.

Table 3 – Interest and Repayment costs as a Proportion of the Net Revenue Budget

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Ratio	7.02%	7.35%	7.83%	8.03%	8.23%

Prudential Indicator 4 – Estimate of Incremental Impact of Capital Investment Decisions on the Council Tax

4.11. This indicator estimates the extra cost of capital investment decisions proposed in this budget report, over and above capital investment decisions that have previously been taken by the Council. Where new capital expenditure is to be financed by borrowing there will be an additional financing cost, this PI represents it in terms of its impact on the level of council tax. It does not mean that council tax will increase by this amount as corresponding efficiencies are made elsewhere in the budget. It acts to illustrate the impact of the capital investment decisions on council tax if taken in isolation.

4.12. Capital expenditure decisions financed by borrowing could in fact feed through to a reduction in the level of council tax if the investment made allows savings to be realised, for example, the capital investment on building a new multi storey car park, might generate sufficient income to cover financing costs and make a surplus thus enabling a reduction to the level of council tax.

4.13. The figures below represent the extra estimated cost in each year of the additional borrowing if it were all funded from council tax.

Table 4 Impact of Capital Expenditure decisions on the level of council tax

	2016/17	**2017/18**	**2018/19**
	£	**£**	**£**
Cost of capital programme on Band D council tax	10.39	12.13	6.68

5. Minimum Revenue Provision Policy Statement

5.1. The Council is required to make a provision (charge to the revenue account) for the repayment of any borrowings it has each financial year, regardless of whether any actual debt is repaid. The Department for Communities and Local Government, (CLG) requires that before the start of each financial year the County Council should prepare a statement of its policy on making such provisions, known as the Minimum Revenue Provision (MRP) for that year.

5.2. The County Council is required to calculate for the current financial year an amount of MRP which it considers to be prudent. The broad aim of prudent provision is to ensure that its underlying borrowing need, as expressed by the CFR, is repaid over a period reasonably commensurate with the life of the capital assets that the borrowing has financed. The statement should indicate which of the options for MRP are to be followed.

5.3. The capital programme has grown very significantly over the past decade. As can be seen in paragraph 4.3 the estimated gross spend for 2015/16 is in excess of £91M and £81M for 2016/17.

5.4. The cost of financing this spend depends partly upon how much is funded by grants and other contributions. These stand at around £78M for 2015/16 and £48M for 2016/17. The remaining spending is predominantly funded through prudential borrowing.

5.5. The borrowing costs are twofold – firstly the interest payable on the loans, currently around 4%, which is payable once the loan is drawn down, often towards the end of the year. The other element is the Minimum Revenue Provision (MRP) which the Council is required to make a provision (charge to the revenue account) for the repayment of any borrowings it has each financial year, regardless of whether any actual debt is repaid.

5.6. The Department for Communities and Local Government, (CLG) requires that before the start of each financial year the County Council should prepare a statement of its policy on making such provisions known as the Minimum Revenue Provision (MRP) for that year.

5.7. The County Council is required to calculate for the current financial year an amount for the MRP which it considers to be prudent. The broad aim of prudent provision is to ensure that the underlying borrowing need, as expressed by the Capital Financing Requirement (CFR), is repaid over a period reasonably commensurate with the life of the capital assets that the borrowing has financed. The statement should indicate which of the options for MRP are to be followed.

5.8. The Cabinet is recommended to note the current MRP Statement approved February 2015:

- For capital expenditure incurred before 1 April 2008 or which is Supported Capital Expenditure, the MRP policy will be based, as now, on the CFR.

- From 1 April 2008 for all unsupported borrowing, the MRP policy will be based on the Asset Life Method. MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must also be applied for any expenditure capitalised under a Capitalisation Directive).

5.9. A review of the capital projects funded by borrowing has been undertaken and concluded that the Council's provision has been overly-prudent and that if we aligned our MRP more closely with the lives of the capital expenditure being financed, there would be a saving to the revenue budget. In 2015/16 this was likely to be in the order of £2.6M while the saving for the 2016/17 base budget would be around £2.4M.

5.10. Changes in MRP policy generally require approval by the County Council. However, this is a change in the method of calculation rather than a change in the policy itself, so full Council approval is not needed. The change in the calculation method has been approved by the Chief Financial Officer and has been agreed by the external auditor KPMG.

5.11. It is important to note that although the MRP changes give us a significant revenue benefit now, there are implications resulting from the change – in particular it will result in an increase in the capital financing requirement over time and/or reduce funding available for new capital projects.

5.12. Looking forwards at the capital programme, there are a large number of schemes to which the Council is already committed (e.g. A338 / Superfast Broadband). It will therefore take a number of years to reduce the burden on the revenue budget without seriously affecting the existing programme.

5.13. The Council is recommended to approve the following MRP Statement:

a) For capital expenditure incurred before 1 April 2008 or which is Supported Capital Expenditure, the MRP policy will be based, as now, on the CFR.

b) From 1 April 2008 for all unsupported borrowing, the MRP policy will be based on the Asset Life Method. MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must also be applied for any expenditure capitalised under a Capitalisation Directive).

6. Treasury Management Strategy 2016/17 to 2018/19

6.1. The capital expenditure plans summarised in Section 4 provide details of the service activity of the Council. 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 the service activity. This involves the organisation of the cash flow and, where capital investment plans require, the organisation of appropriate borrowing facilities.

6.2. The treasury management service is therefore an important part of the overall financial management of the Council's affairs. The prudential indicators consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The Treasury Management service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

6.3. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised 2011). The Council adopts the Code of Practice on Treasury Management and its revisions, which in itself is a key Prudential Indicator that it has complied with. As a result of adopting the Code, the Council also agreed to create and maintain a Treasury Management Policy Statement (TMPS) which states the policies and objectives of the Council's Treasury Management activities.

6.4. It is a requirement for an annual strategy to be reported to the Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

6.5. The strategy document covers:

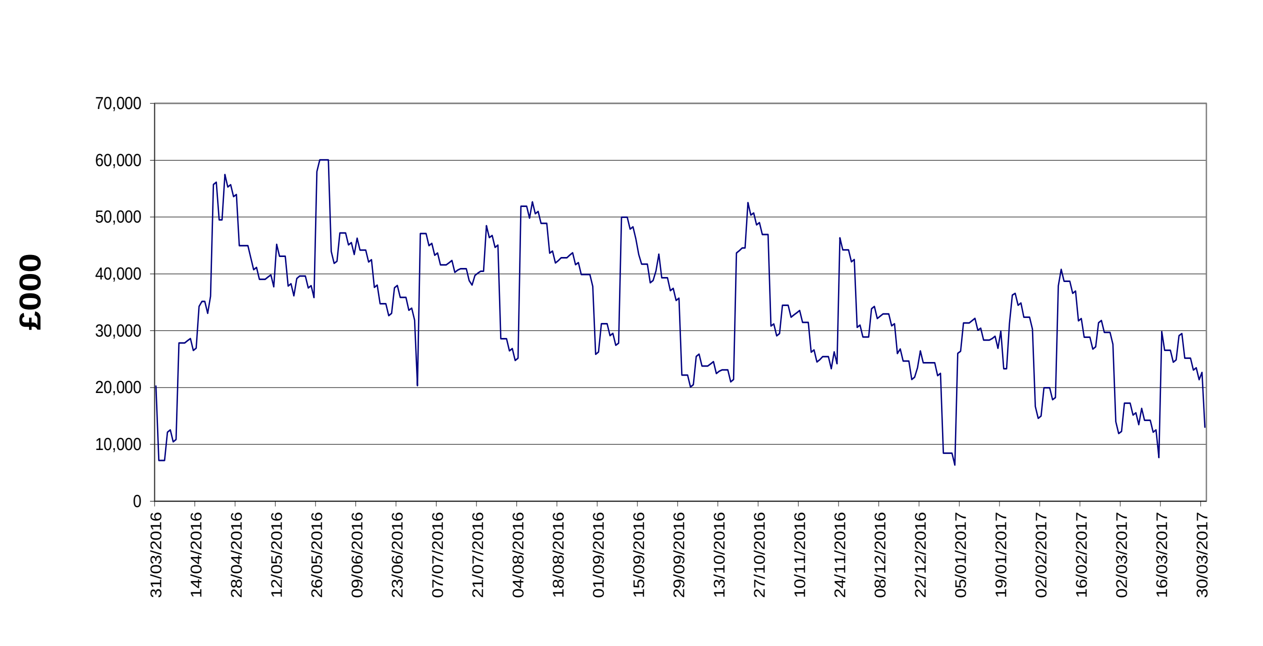
a) An update on deposits held with the Icelandic Banks;
b) A consideration of the economic outlook and the prospects for interest rates;
c) An outline of the forecast cash position of the Council;
d) The borrowing strategy;
e) The prudential indicators that affect the borrowing strategy;
f) The investment strategy for the year;
g) An analysis of sensitivities to interest rates;
h) The Performance Indicators;
i) Treasury Management Advice;
j) Member and Officer Training.

Day to Day Cash Management Activity

6.6. The Council's cash balances will fluctuate throughout the year as income is received and expenditure is made. Chart 1 shows the projected cashflow forecast for 2016/17 which is based on high level budget figures, historic trends and other information. It shows cash balances fluctuate between major receipt days, when government grant or the council tax precepts are received and major payment days such as the employees pay day. The maximum level of cash balances is expected to be around £60m with the minimum level being £7m. Expected interest earnings are based on the cash flow as set out below (average balance approximately £35m) assuming an average interest rate of 0.65%.

6.7. The Council is by law expected to set a balanced budget, meaning that its cash inflows should broadly match its cash outflows over the medium term. The chart provides a useful guide to officers when formulating the borrowing and investment strategy.

Chart 1 – Dorset County Council Cashflow Forecast 2016/17



Borrowing Strategy

6.8. The Council can borrow long term funds from three main sources:

a) The Public Works Loans Board (PWLB) is the government agency that provides long term funding to local authorities, with loans priced according to the gilt markets. Loans can be taken for periods of 1 to 50 years at fixed or variable rates.
b) The Banking Sector also offer long term 'market' loans. The Council will consider borrowing from banks and financial institutions on a long term basis if this method of funding is advantageous compared to any other options available. Institutions have in the past offered loans up to 70 years and on a forward delivery basis.
c) Internal Borrowing from Revenue Balances can be used to fund the capital programme. Cash balances are built up over time from the Council's on-going activities, and as the Council builds up reserves and makes provisions these are reflected in the cash balances it holds. The cash held can be used to finance the capital programme, instead of borrowing externally. In reality the decision to borrow from cash balances will depend on the prevailing interest rate environment.

6.9. The borrowing strategy is affected by the economic outlook and prospects for interest rates. The low investment returns (less than 1.0%) compared to the cost of long term borrowing (c. 3.5%) has meant the Council has been using its cash balances to fund capital spend rather than borrow. This has resulted in the Council's level of debt being significantly less than its CFR. This strategy means the Council is expected to be 'under borrowed' by approximately £111m at 31 March 2016. This has been deemed to be a prudent approach because of the low investment returns and relatively high counterparty risk.

6.10. However, with borrowing costs forecast to increase at some stage over the next three years, and given the current high level of internal borrowing, attention needs to be given to the balance between internal and external borrowing. Over the next two years it may be prudent to borrow at lower rates and incur a cost of carry (the difference between the rate of interest earned on investments against the cost of borrowing), in the knowledge that future long term borrowing is likely to be higher. The Chief Financial Officer will continue to monitor interest rates in the financial markets and adopt a pragmatic approach to changing circumstances when making borrowing and investment decisions.

6.11. Officers regularly consider opportunities to reschedule borrowing whereby debts at a higher rate of interest are repaid and rescheduled at a lower interest rate. However, changes to the restructuring penalties (premiums) charged by the PWLB have made such restructurings expensive and therefore unviable at current market rates.

7. Treasury Management Prudential Indicators 2016/17 to 2018/19

7.1. The Prudential Code places a number of restrictions on the debt management activities of the Council. These are to restrain the activity of the treasury function within certain limits to manage risk and reduce the impact of any adverse or sudden movements in interest rates. However, the limits have to be with sufficient flexibility to allow costs to be minimised and performance maximised.

Prudential Indicator 5 – External Debt

7.2. The Council needs to ensure that its long term gross debt does not exceed the projected CFR for the third year of the capital programme plans (the 2018/19 projected CFR in the case of this plan). This prevents the Council from over borrowing in the long term and thereby taking on excessive levels of debt, which could be unaffordable or unsustainable. However, it does provide the Council with the flexibility to borrow in advance of need if borrowing rates are favourable, or they are expected to increase.

7.3. External debt and other long term liabilities (including PFI contract and finance lease commitments) is expected to stand at £184m at 31 March 2016, significantly less than the CFR, which is estimated to stand at £334m at the same date, representing underborrowing of approximately £111m. The breakdown of this plus estimates of borrowing for 2016/17 to 2018/19 are summarised in Table 5.

Table 5 – External Debt Actual and Estimates 2014/15 – 2018/19

External Debt	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Debt at 1 April	213,871	215,124	184,341	204,341	234,341
Expected change in Debt	1,253	-30,783	20,000	30,000	20,000
PFI / Finance Lease Liabilities	45,664	42,042	38,420	34,798	31,176
Expected change in PFI Liabilities	-3,622	-3,622	-3,622	-3,622	-3,622
Actual gross debt at 31 March	**257,166**	**222,761**	**239,139**	**265,517**	**281,895**
CFR	334,887	333,807	352,691	375,532	386,595
Under / (Over) Borrowing	**77,721**	**111,046**	**113,552**	**110,015**	**104,700**

Prudential Indicators 6 and 7 – Operational Boundary and Authorised Limits for External Debt

7.4. These indicators are at the core of the Prudential Code and reflect the limits that the Council imposes upon itself in relation to external borrowing.

7.5. The Operational Boundary is the limit beyond which external debt is not normally expected to exceed. In the majority of cases this should be a level similar to the CFR, plus an allowance for any short term borrowings that might be required for cash management purposes or unexpected calls on capital resources. It is the key management tool for in year monitoring of the Council's expected capital and cashflow borrowing position.

Table 6 Operational Boundary for External Debt 2015-2019

	2015/16 £000	**2016/17 £000**	**2017/18 £000**	**2018/19 £000**
Borrowing	335,000	335,000	345,000	360,000
Other long term liabilities	40,000	40,000	40,000	40,000
Total Operational Boundary	**375,000**	**375,000**	**385,000**	**400,000**

7.6. The proposed operational boundaries for external debt set out in Table 6 are based on the most likely, prudent, but not worst case scenario to allow for unusual cash movements, for example. For reference purposes they include the estimated level of CFR, and estimated levels of borrowing for each year. The policy of limiting the size of the CFR is reflected in the proposed operational boundary, which will be capped at the maximum level of the CFR plus £10m to allow for any short term cashflow borrowing. These limits separately identify borrowing from other long term liabilities such as finance leases.

7.7. The Authorised Limit for external debt uses the operational boundary as the starting point but includes a margin to allow for unusual and unpredicted cash movements. By its very nature, this margin is difficult to predict and it will be necessary to keep it under review for future years.

7.8. The Authorised Limit may not be affordable or sustainable in the long term, but represents the absolute maximum level of debt the Council can hold at any given time. It is a statutory limit determined under section 3 (1) of the Local Government Act 2003, and any breach will be reported to the County Council, with the Government having the option to control the plans of the Council. An allowance has been added to the operational boundary to provide for the possibility of extra borrowing becoming available during the year as the result of the Government supporting further schemes, as well as providing some headroom if the projection of cashflow borrowing were to change.

7.9. In respect of its external debt, it is recommended that the County Council approves the authorised limits, set out in Table 7, for its total external debt for the next three financial years.

Table 7 Authorised Limit for External Debt 2014/15 – 2018/19

	2015/16 £000	**2016/17 £000**	**2017/18 £000**	**2018/19 £000**
Borrowing	355,000	355,000	365,000	380,000
Other long term liabilities	42,000	42,000	42,000	42,000
Total Authorised Limit	**397,000**	**397,000**	**407,000**	**422,000**

7.10. The Council is asked to delegate authority to the Chief Financial Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities on both the operational boundary and authorised limits. Any such changes made will be reported to the Council at its next meeting following the change.

Prudential Indicators 8, 9 and 10 – Limits on interest rate exposure and maturity of debt

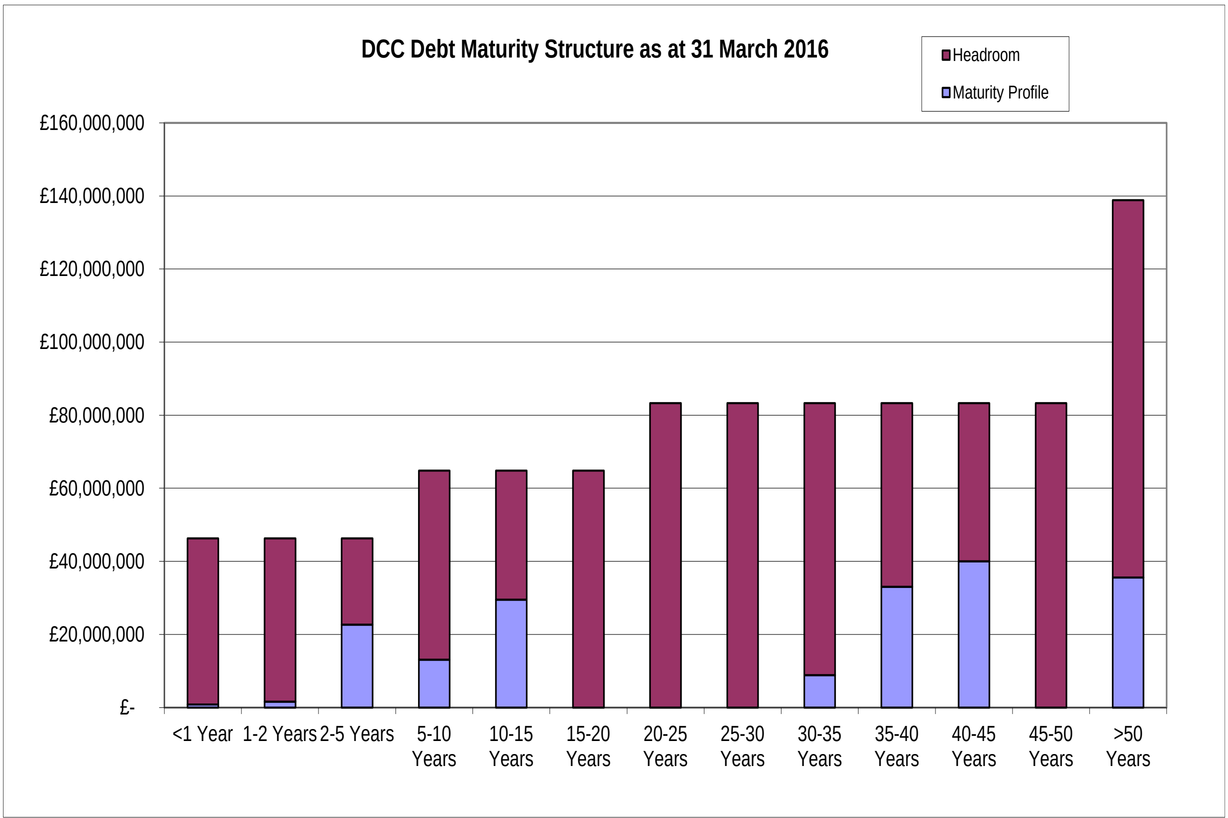
7.11. These three PIs are designed to minimise exposure to fluctuations in interest rates and refinancing risks, and also cap the interest costs of borrowing to provide stability to this area of the Council's finances. The indicators are detailed below and illustrated in Table 8 and Chart 2:

a) Upper limit on fixed interest rate exposure – this identifies a maximum revenue cost of interest paid on fixed rate debts and is intended to prevent the Council from being locked into rates of interest that it cannot easily exit.
b) Upper limit on variable interest rate exposure – this identifies a maximum revenue cost of interest paid on variable debts, which is designed to minimise the budget exposure of the Council to movements in interest rates, a sudden increase in variable interest rates can cost the Council a significant sum of money, which this limit is intended to cap.
c) Maturity Structure of Borrowing – this identifies the maximum level of exposure to loans maturing (being repaid) in any given year. The rationale is to prevent the Council from having adverse cashflow difficulties if a large proportion of its loans have to be repaid in the same year. Chart 2 shows the current maturity profile, in relation to the limits that have been set.

Table 8 – Limits on Interest Exposure and Maturity of Debt

	2016/17 Upper £000	2017/18 Upper £000	2018/19 Upper £000
PI 8 Limits on net fixed interest rates	12,000	13,000	13,000
PI 9 Limits on net variable interest rate	2,000	2,000	2,000
PI 10 Maturity Structure of fixed interest rate borrowing 2016/17		**Lower**	**Upper**
Under 12 Months		0%	25%
12 Months to 2 Years		0%	25%
2 Years to 5 Years		0%	25%
5 Years to 10 Years		0%	35%
10 Years to 15 Years		0%	35%
15 Years to 20 Years		0%	35%
20 Years to 25 Years		0%	45%
25 Years to 30 Years		0%	45%
30 Years to 35 Years		0%	45%
35 Years to 40 Years		0%	45%
40 Years to 45 Years		0%	45%
45 Years to 50 Years		0%	45%
50 Years and above		0%	75%

Chart 2 – Debt Maturity Limits compared to Actual Debt Maturity Profile Projected at 31 March 2016



8. Annual Investment Strategy

8.1. Cash balances are invested on a daily basis using the London Money Market, call accounts, pooled money market funds and by making deposits with the Council's bank. Longer term investments can also be made; and in the current market, such investments earn more interest than the shorter term investments, however, there is a balance to be achieved between ensuring availability of cash to pay the bills and taking advantage of these higher interest rates. In the current banking and financial climate there is also a higher risk of counterparty default. In practice there will be a range of investments, but with a current bias heavily towards shorter term deposits.

8.2. The primary objectives of the Council's investment strategy are detailed in the Investment Policy detailed in Appendix 1. The objectives, in order of priority, are:

a) The security of funds invested – ensuring that the funds will be repaid by the counterparty to the Council at the agreed time and with the agreed amount of interest;
b) The liquidity of those funds – ensuring the Council can readily access funds from the counterparty;
c) The rate of return – ensuring that given a) and b) are satisfied that return is maximised.

8.3. The Investment Policy takes into account the economic outlook and the position of the banking sector in assessing counterparty security risk. Since the banking crisis of 2008, there continue to be underlying concerns about both the shape of the economy and the stability of the banking sector meaning the operational investment strategy adopted by the Council has tightened the controls already in place in the approved investment strategy. In doing so the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the Specified and Non-Specified investment sections explained in Annex A of the Investment Policy. Risk of default by an individual borrower is minimised by placing limits on the amount to be lent.

8.4. The Policy introduces further measures that are taken to minimise counterparty risk, as a result officers work to:

- a prescribed list of countries that it can invest in;
- a list of institutions that it can invest with,
- maximum cash limits that can be invested with these institutions, and
- restrictions on the length of time investments can be held with these approved institutions.

8.5. The counterparty list is maintained by Capita who monitor it on a real time basis. The Council receives a weekly update, but a new list can be distributed at any time if there is any adverse news about any of the institutions on it.

8.6. In addition to the restrictions that the Council places upon itself to maximise security, ensure liquidity and maximise yield, the prudential code sets limits on the maximum period of time monies can be invested for. These are illustrated in Table 9 below

Table 9 Prudential Indicator 11 – Maximum principal sums invested >364 days

	2016/17 £000	**2017/18 £000**	**2018/19 £000**
Maximum amount invested > 364 Days	20,000	20,000	20,000
% of which can be up to 2 years	100%	100%	100%
% of which can be up to 3 years	75%	75%	75%
% of which can be up to 4 years	50%	50%	50%
% of which can be up to 5 years	25%	25%	25%

8.7. The limit on the maximum amount that can be invested for more than one year has been reduced from £30M to £20M, to reflect the fact that the Council's cash balances have reduced, and are expected to continue to fall over the medium term. This will be kept under review as, when we reduce our internal borrowing, our cash balances will start to increase.

Icelandic Banks Update

Heritable

8.8. A claim was registered with the administrators, Ernst & Young, for £13,276,929, being the principal outstanding and interest accrued to 7 October 2008.

8.9. The administrator has made 15 separate repayments to date; the most recent of these being received on 26 August 2015 for £528,774. The total amount returned to date is £13,011,391 or 98% of the claim. The loan remains on the Council's balance sheet but is fully impaired which means that any further payments received can be returned to the Council's reserves.

Landsbanki

8.10. In February 2014 the Council was one of a large number of creditors who sold its claims against the insolvent estate of Landsbanki (LBI). The loan has therefore been removed from the Council's balance sheet.

9. Sensitivity to Interest Rate Movements

9.1. The Council's accounts are required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. Table 10 highlights the estimated impact of a 1% increase or decrease in all interest rates to the estimated treasury management costs or income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Table 10 Impact on Revenue Budget of a 1% Change in Interest Rates

	Variable Rate Debts / Investments £000	**2016/17 Estimated + 1% £000**	**2016/17 Estimated - 1% £000**
Interest on Borrowing[1]	0	0	0
Investment Income[2]	35,000	350	(350)
Net Benefit / (Cost) to Council		350	(350)

1) The Council is not expected to hold any variable rate debt in 2016/17.

2) Average projected balances for 2016/17.

10. Risk Assessment

10.1. The primary risks to which the County Council is exposed in respect of its treasury management activities are adverse movements in interest rates and the credit risk of its investment counterparties. Either may jeopardise the Authority's ability to maintain its financing strategy over the longer term.

10.2. The net interest costs of the Authority are not significant in relation to its overall revenue budget. Significant changes in the level of interest rates are unlikely to result in an unmanageable burden on the budget position of the County Council.

10.3. Treasury Management risk can be reduced in the following ways:

- diversification of lending by setting criteria and limits for investment categories and individual borrowers. Risk is controlled by the formulation of suitable criteria for assessing and monitoring the credit risk of borrowers and the construction of the lending list comprising time, type, sector and specific counterparty limits. This is covered in more detail in the following section.
- balancing cash flow needs, as determined by the forecast, with the outlook for interest rates, whilst ensuring enough cover for emergencies
- use of money market funds and longer term lending to enhance diversification.

10.4. In addition, the CIPFA Code requires the policy to show who is responsible for which decision, the limits on the delegation and reporting requirements. This has been in place for some years and is reproduced at Appendix 2.

10.5. The Council's Treasury Management Practices document sets out in detail the systems and processes (including internal checks) that have been introduced to reduce the risk of losses due to fraud, negligence and error.

11. Performance Indicators

11.1. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing – Average rate of borrowing for the year compared to average available;
- Debt – Change in the average cost of debt year on year;
- Investments – Internal returns above the 7 day LIBID rate.

11.2. In managing Treasury Management performance a number of annual benchmarking exercises are done to monitor the relative performance and to ensure best practice, this benchmarking includes these performance indicators and represents the most effective way of managing performance. A review of performance is presented as part of the Outturn Report in July.

12. Member and Officer Training

12.1. The high level of risk inherent in treasury management means officers need to be adequately experienced and qualified. Officers attend national treasury management events and training courses and have twice yearly strategy and review meetings with Capita, as well as regular contact over the telephone.

12.2. A training session for all elected Members was held in April 2014 and run by Capita to explain the basics and outline the responsibilities that Members have in relation to treasury management. It is Dorset County Council policy to offer training to Members where it is felt to be appropriate and relevant, and it is planned to arrange a further session in 2016/17.

13. Conclusion

13.1. This report sets out the Treasury Management Strategy for 2016/17 to 2018/19 and, in particular, shows the anticipated cash flow for the Council and how in practice this is to be managed to optimise interest earnings and minimise borrowing cost whilst meeting daily cash needs.

13.2. An extensive risk analysis has been carried out on the treasury management operation supported by the County Council's treasury management advisers, Capita Asset Services, and it is considered that a high level of risk avoidance has been established by the combination of policies and working practices in place. Particular attention is given to the quality of lenders used and the processes used on a day to day basis to avoid any losses due to fraud, negligence, and error.

13.3. Various options exist regarding the precise manner in which the capital programme is financed, and these are highlighted in paragraph 6.9. The Code of Practice provides that final decisions on the actual financing of capital expenditure, rests with the Chief Financial Officer after taking advice from Capita.

13.4. As required by the Code, the report sets out the required Prudential Indicators and in accordance with the guidance any revisions required will be brought to the Cabinet for approval.

Richard Bates

Chief Financial Officer

January 2016

APPENDIX 1

Dorset County Council - Investment and Credit Worthiness Policy

1. Introduction: changes to credit rating methodology

1.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "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. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

1.2 In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

1.3 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, clients 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 AAA. 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.

1.4 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

2. Investment Policy

2.1 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, then return.

2.2 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.

2.3 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 advisers to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

2.4 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.

2.5 Investment instruments identified for use in the financial year are listed in Annex A of this Policy under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices schedules.

3. Creditworthiness Policy

3.1 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains this policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in Annex A - Specified and Non-Specified investments; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

3.2 Risk of default by an individual borrower is minimised by placing limits on the amount to be lent. These limits use, where appropriate, credit ratings from Fitch, Standard and Poors, and Moodys Credit Rating Agencies. All banks and building societies used by Dorset County Council will have a long-term rating of at least A- and a minimum short term rating of F1. Long-term ratings vary from AAA (the highest) down to D the lowest. Short-term ratings vary from F1+ (the highest) down to D. Individual ratings vary from A (the highest) down to E, and these are now being replaced by viability ratings (aaa the highest, to c the lowest) and estimate how likely the bank is to need assistance from third parties. The limits to be used are set out in paragraph 3.6.

3.3 The Chief Financial Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which type of investment instrument are either Specified or Non-Specified investments as it provides an overall pool of counterparties considered to be high quality that the Council may use, rather than defining what types of investment instruments are to be used.

3.4 Credit rating information is supplied by the Council's treasury management advisers, Capita Asset Services, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of a possible longer term change) are monitored and provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

Security

3.5 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

i. Sovereign Ratings

3.5.1 The Council will only lend to counterparties in countries with the highest sovereign Credit Rating of AAA. The maximum that can be deposited with banks in any one sovereign is £30m at any time. The exception to both rules is the United Kingdom.

ii. Counterparties with Good Credit Quality

3.5.2 The Council will lend to counterparties with the following counterparty ratings:

Table 1 Counterparty Ratings

Category	Minimum Credit Rating	Limit
Any Local Authority	n/a	£15 Million
Banks & Building Societies	Short F1, Long A-	£15 Million
Money Market Funds	AAA	£15 Million (individual)
Money Market Funds Notice Account	AAA	£10 Million (individual)
UK Government including gilts and the Debt Management Account Deposit Facility (DMADF)	n/a	no limit

3.5.3 Where a counterparty is part of a larger group, it is appropriate to limit the Council's overall exposure to the group. Individual counterparties within the group will have their own limit, but will be subject to an overall limit for the group. The limit for any one group will be £15M, except in the case of the four major UK banking groups where the limit is £20M.

iii. Part Nationalised Banking Groups

3.5.4 The Council will continue to use banking groups whose ratings fall below the criteria specified above if that banking group remains part nationalised, up to a limit of £20M for the group.

iv. Council's own banker

3.5.5 The limit for the Authority's own bank is £20M, however, due to occasional short term unexpected cashflows this limit may be breached. For this reason additional flexibility of an additional £1M is allowed to cover such movements, and to minimise the transaction costs involved with moving small sums of money. Over the long term the £20M should be the maximum. The breaches of the £20M limit will be monitored and reported to the Chief Financial Officer on a monthly basis.

3.5.6 If the Council's own banker, NatWest, fell below the Council's criteria, it would continue to be used for transactional and clearing purposes with the maximum balances deposited with them overnight being limited to £500k.

v. Major UK Banks

3.5.7 The Council may invest up to £20M with each of the four major UK banking groups, Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC, and The Royal Bank of Scotland PLC (which owns the Council's bank, National Westminster Bank PLC), taking into account the restrictions of group limits and any other limits which apply. These four banking groups were added explicitly to the Treasury Management Strategy with the rationale that in a worst case scenario, all of the Council's cash could be placed across these four banks.

vi. Use of Additional Information other than Credit Ratings

3.5.8 Additional requirements under the Code of Practice require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches / Outlooks) will be applied to compare the relative security of differing investment counterparties.

Liquidity

3.6 Liquidity is defined as an organisation "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice).

3.7 In addition it is prudent to have rules for the balance of investment between short term and longer term deposits to maintain adequate liquidity. They are:

i. Fixed Term Investments

3.8 A minimum cash balance of £10M must be maintained in call accounts or instant access Money Market Funds. Any amount above this can be invested in fixed term deposits.

ii. Call Deposits

3.9 The amount of call deposits (instant access accounts) should be a minimum of £10M to allow for any unforeseen expenditures, up to a maximum of 100%. From time to time, it may be necessary for call deposits to fall below £10M, when this occurs it should be for no more than one working day. The breaches of the £10M limit will be monitored and reported to the Chief Financial Officer on a monthly basis.

iii. Time and Monetary limits applying to Investments

3.10 The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

Table 4 – Time and Monetary Limits

	Minimum Long Term and Short Term Counterparty Rating (LCD Approach)	**Money Limit**	**Time Limit**
Any Local Authority	n/a	£15 Million	5 Years
Banks & Building Societies	AA- / F1+	£15 Million	5 Years
Banks & Building Societies	A- / F1	£15 Million	364 Days
Major UK Banks*	n/a	£20 Million	5 Years
Money Market Funds	AAA	£15 Million (individual)	Overnight
Money Market Funds	AAA	£10 Million (individual)	7 Day Notice
UK Government including gilts and the DMADF	n/a	Unlimited	6 Months
Part Nationalised Banking Groups	n/a	£20 Million	5 Years
Council's Own Banker	n/a	£20 Million	Overnight
*(Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC and The Royal Bank of Scotland PLC)			

iv. Longer Term Instruments

3.11 The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-Specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will be limited to counterparties rated AA- long term, and F1+ short term. The level of overall investments should influence how long cash can be invested for. For this reason it has been necessary to introduce a sliding scale of limits that depend on the overall size of cash balances. The smaller the size of the overall cash balances the more important it is that the money is kept liquid to meet the day to day cashflows of the organisation. Likewise if cash balances are large, a greater proportion of the funds can be invested for longer time periods. Table 5 sets out the investment limits.

Table 5 Time Limits for Investments over 365 days

Time Limit	**Money Limit invested with Counterparties rated AA- - F1 + and above – or UK 4 Major Banking Groups**	
Projected Annual Balances	**%**	
More than 1 year, no more than 2 years	100%	£20M
More than 2 years, no more than 3 years	75%	£15M
More than 3 years, no more than 4 years	50%	£10M
More than 4 years, no more than 5 years	25%	£5M
In Total £M		**£20M**

3.12 In the normal course of the council's cash flow operations it is expected that both Specified and Non-Specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

3.13 A summary of the proposed criteria for investments is shown in Annex B, and a list of counterparties as at 11 January 2016 in accordance with these criteria is shown as Annex C to this policy for information.

Investment Policy - Treasury Management Practice 1- ANNEX A

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The CLG issued Investment Guidance on April 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sector Guidance Notes. This Council adopted the Code during 2002 and will apply its principles to all investment activity. In accordance with the Code, the Chief Financial Officer has produced the Council's treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy

The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is set out below.

Strategy Guidelines

The main strategy guidelines are contained in the body of the treasury strategy statement (the Investment Strategy).

Specified Investments

These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Office, UK Treasury Bills or gilt with less than one year to maturity).

2. Supranational bonds of less than one year's duration.

3. A local authority, parish council or community council

4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.

5. A body that is considered of a high credit quality (such as a bank or building society). This covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies.

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as specified above). This would include investments greater than 1 year in duration. It is proposed that counterparties will be restricted to those in the specified category above when investing for more than a year. In total these longer term loans will be limited to £50M of the total investment portfolio and this has been determined with regard to the forecasts of future cash flow.

The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Financial Officer, and if required new counterparties which meet the criteria will be added to the list.

Summary of Investment Criteria

INVESTMENT POLICY ANNEX B

Paragraph	Criteria	Minimum Rating		Maximum Investment and Exceptions
		Long	Short	
Sovereign Limit for All Loans				
3.5.1	**AAA Sovereign Rating**	n/a	n/a	£20 Million with any one sovereign, UK no limits
Notice Money				
A minimum of 10% of total investments, up to a maximum of 100%				
3.5.5	**Council's own Banker**	n/a	n/a	£20 Million
3.5.2	**Money Market Funds**	AAA		£15 Million individual
3.5.2	**Money Market Fund Notice Account**	AAA	n/a	£10 Million individual
Fixed Term Investments				
Limited to the amount of excess balances for that term less a margin of £10 Million				
Up to 6 months				
3.5.2	**UK Government including gilts and DMADF**			Unlimited
Up to 364 Days				
3.5.2	**Any Local Authority**			£15 Million
3.5.2	**Banks & Building Societies**	A-	F1	£15 Million Note that no more than £15 Million can be invested with banks in the same group where the highest rated counterparty has a minimum of these ratings See 3.5.4, 3.5.5, 3.5.6, 3.5.7 for exceptions
3.5.7	**Four Major UK Banking Groups**: Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC, The Royal Bank of Scotland PLC (including National Westminster Bank PLC)	N/a	N/a	£20 Million
Up to 5 years				
3.5.7	**Major Banks & Building Societies**	AA-	F1+	£15 Million per bank Note that no more than £15 Million can be invested with banks in the same group where the highest rated counterparty has a minimum of these ratings See 3.5.4, 3.5.5, 3.5.6, 3.5.7 for exceptions
3.5.4	**Part Nationalised Banking Groups:** Lloyds Banking Group PLC, The Royal Bank of Scotland PLC (including National Westminster Bank PLC)	n/a	n/a	£20 Million

INVESTMENT POLICY ANNEX C

Counterparty list as at 11 January 2016

	Lowest Long Term Rating*	**Lowest Short Term Rating***	**Money Limit (£M)**	**Time Limit**
UK Banks and Building Societies				
HSBC Bank PLC	AA-	F1+	£20M	5 YEARS
Lloyds Banking Group:				
Bank of Scotland PLC	A+	F1	£20M (group)	5 YEARS
Lloyds Bank PLC	A+	F1	£20M (group)	5 YEARS
Royal Bank of Scotland Group:				
National Westminster Bank	BBB+	F2	£20M (group)	5 YEARS
Royal Bank of Scotland	BBB+	F2	£20M (group)	5 YEARS
Barclays Bank	A	F1	£20M	5 YEARS
Santander UK Plc	A	F1	£15M	364 DAYS
Standard Chartered Bank	A+	F1	£15M	364 DAYS
Nationwide Building Society	A	F1	£15M	364 DAYS
Goldman Sachs International Bank	A	F1	£15M	364 DAYS
Close Brothers Ltd	A	F1	£15M	364 DAYS
Sumitomo Mitsui Banking Corporation Europe Limited	A	F1	£15M	364 DAYS
Coventry Building Society	A	F1	£15M	364 DAYS
Leeds Building Society	A-	F1	£15M	364 DAYS
UBS Ltd	A	F1	£15M	364 DAYS
Abbey National Treasury Services	A	F1	£15M	364 DAYS
Australian Banks				
National Australia Bank Limited	AA-	F1+	£15M	5 YEARS
Australia and New Zealand Banking Group	AA-	F1+	£15M	5 YEARS
Commonwealth Bank of Australia	AA-	F1+	£15M	5 YEARS
Macquarie Bank Limited	A	F1	£15M	364 DAYS
Westpac Banking Corporation	AA-	F1+	£15M	5 YEARS

	Lowest Long Term Rating*	Lowest Short Term Rating*	Money Limit (£M)	Time Limit
Canadian Banks				
Canadian Imperial Bank of Commerce	AA-	F1+	£15M	364 DAYS
Bank of Montreal	AA-	F1+	£15M	364 DAYS
Bank of Nova Scotia	AA-	F1+	£15M	364 DAYS
National Bank of Canada	A+	F1	£15M	364 DAYS
Royal Bank of Canada	AA	F1+	£15M	5 YEARS
Toronto-Dominion Bank	AA-	F1+	£15M	5 YEARS
Danish Banks				
Danske A/S	A	F1	£15M	364 DAYS
German Banks				
Landwirtschaftliche Rentenbank	AAA	F1+	£15M	5 YEARS
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	£15M	5 YEARS
Landesbank Hessen-Thuringen Girozentrale	A+	F1+	£15M	364 DAYS
Landesbank Baden-Wurttemberg	A-	F1	£15M	364 DAYS
NRW Bank	AAA	F1+	£15M	5 YEARS
Luxembourg Banks				
European Investment Bank	AAA	F1+	£15M	5 YEARS
Singaporean Banks				
DBS Bank Ltd.	AA-	F1+	£15M	5 YEARS
Oversea-Chinese Banking Corp	AA-	F1+	£15M	5 YEARS
United Overseas Bank Limited	AA-	F1+	£15M	5 YEARS
Swedish Banks				
Nordea Bank AB	AA-	F1+	£15M	5 YEARS
Svenska Handelsbanken	AA-	F1+	£15M	5 YEARS
Swedbank AB	A+	F1	£15M	364 DAYS
Skandinaviska Enskilda Banken AB	A+	F1	£15M	364 DAYS
Swiss Banks				
UBS AG	A	F1	£15M	364 DAYS
Credit Suisse AG	A	F1	£15M	364 DAYS

APPENDIX 2

Policy of Delegation

The Code requires the policy of delegation to show who is responsible for which decision, the limits on the delegation and reporting requirements.

The code also requires the responsibilities of council, committee and Chief Officers to be set out. In summary they are as follows: -

The County Council – approval of recommendations from the Cabinet and annually the borrowing limits.

The Cabinet – approval of the Treasury Management Strategy Statement, and from time to time the review of the Treasury Management Strategy Statement.

Audit & Scrutiny Committee – to ensure effective scrutiny of the treasury management strategy and policy, through receiving regular reports from the Chief Financial Officer.

The Chief Financial Officer – approval of draft policy statement, regular monitoring of activities and reporting on these activities to Committee.

Chief Treasury & Pensions Manager – monitor implementation of policy, review policy, preparation of monitoring reports for the Chief Financial Officer, appointment of money brokers and advisers.

Finance Manager (Treasury & Investments) – monitor day to day implementation of policy set and approval of deals on a day to day basis.

Investment Technician – carry out day to day deals in accordance with policy.

Head of the paid service – the Chief Executive – that the system is laid down and resourced and that the Chief Financial Officer makes the required regular reports to elected members.

Monitoring Officer – the Head Legal Services – ensuring compliance by the Chief Financial Officer.

Internal Audit – the policing of the arrangements.

In addition to these delegations there is in place a comprehensive system of checks within Corporate Resources involving several members of staff, which operates on each individual money deal.