Gedling Borough Council

Report to Cabinet

Subject: Prudential and Treasury Indicators and Treasury Strategy 2014/15

Date: 20 February 2014

Author: Corporate Director (Chief Financial Officer)

Wards Affected

All

Purpose

To present, for members' approval, the Council's Prudential Code Indicators and Treasury Strategy for 2014/15.

Key Decision

This is not a key decision.

Background

1.1 Definition of treasury management

Treasury management is defined 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."

It is a statutory requirement for the Council to produce a "balanced budget", which broadly means that cash raised during the year will meet cash expenditure. The Localism Act 2011 places a duty on a local authority to calculate its "council tax requirement" for each financial year, and this includes the revenue costs which result from the capital investment decisions of the authority.

Part of the treasury management service is to ensure that cashflow is adequately planned, with cash available when it is needed. Surplus cash is invested with counterparties commensurate with the Council's low risk appetite, providing adequate liquidity before considering investment return.

A further treasury management function is the funding of capital plans. These plans provide a guide to the Council's borrowing needs, and require longer term cashflow planning to ensure the Council can meet its spending obligations. The management of longer term cash may involve arranging long or short-term loans or the use of longer term cashflow surpluses.

1.2 Statutory reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

1.2.1 Prudential and treasury indicators and treasury strategy (this report)

This first, and most important report covers:

- The capital plans (including prudential indicators),
- A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time),
- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators,
- An investment strategy (the parameters on how investments are to be managed).

1.2.2 Mid-year treasury management report

This updates members on the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is appropriate or whether any policies require revision. Gedling Borough Council has long adopted a policy of presenting quarterly treasury management reports to Cabinet, and this exceeds the minimum requirement.

1.2.3 Annual treasury report

This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.2.4 Scrutiny

All treasury management reports are initially considered by Cabinet, before being recommended to Council for approval. The TMSS is part of the Council's Budget and Policy Framework and accordingly the Chair of the Overview and Scrutiny Committee has also been notified. Any comments received will be taken into account before referral to Council.

1.3 Treasury management strategy for 2014/15

The strategy for 2014/15 covers two main areas:

Capital issues:
- the capital plans and the prudential indicators
- the minimum revenue provision (MRP) policy

Treasury management Issues:
- the current treasury position
- treasury indicators which limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny and the Chief Financial Officer will arrange training as required.

The training needs of officers involved with treasury management are reviewed periodically.

1.5 Treasury management consultants

The Council uses Capita Asset Services, Treasury Solutions (CASTS - previously branded as Sector) as its treasury management advisors, recognising that there is value in employing external providers in order to acquire access to specialist skills and resources. The Council will ensure that the terms of appointment and the methods by which value will be assessed are properly agreed and documented, and subjected to regular review. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times, and will ensure that undue reliance is not placed upon the external service providers.

Proposal

2.1 The Capital Prudential Indicators 2014/15 to 2016/17

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members to overview and confirm such capital expenditure plans. The indicators for 2014/15 to 2016/17 are attached at Appendix 1.

2.1.1 Capital expenditure

The indicator includes a summary of both the capital expenditure plans previously agreed, and those that are part of the current cycle.

Portfolio Capital Expenditure £	**2013/14 Current Estimate £**	**2014/15 Estimate £**	**2015/16 Estimate £**	**2016/17 Estimate £**
Community Developm't	19,400	0	0	0
Health & Housing	1,000	686,000	596,000	596,000
Public Prot'n & Comm'n	866,400	0	0	0
Environment	1,202,800	1,575,500	1,134,000	790,000
Leisure & Development	934,500	490,600	0	0
Finance & Performance	1,042,300	150,000	150,000	150,000
Equipm't Replacement	0	0	150,000	150,000
Service Devel. Bids	0	0	100,000	100,000
Total Expenditure	**4,066,400**	**2,902,100**	**2,130,000**	**1,786,000**

The table below summarises the above capital expenditure plans and how these are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Resources £	**2013/14 Current Estimate £**	**2014/15 Estimate £**	**2015/16 Estimate £**	**2016/17 Estimate £**
Capital Exp £m (above)	**4,066,400**	**2,902,100**	**2,130,000**	**1,786,000**
Financed by:				
Capital receipts	500,000	1,691,100	1,759,000	1,415,000
Capital grants & contributions	1,331,700	1,211,000	371,000	371,000
Net borrowing need	**2,234,700**	**0**	**0**	**0**

2.1.2 The Council's borrowing need – the Capital Financing Requirement (CFR)

In simple terms, the CFR is the total historic outstanding capital expenditure which has not yet been paid for, from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure in the tables above, which has not immediately been paid for by way of capital receipts, grants or contributions, will increase the Council's CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The CFR can include any other long term liabilities, for example finance leases and PFI schemes. Whilst these would increase the CFR, and therefore the borrowing requirement, such schemes would include their own borrowing facilities and the Council would not be required to separately borrow for them. The Council has no such schemes within its CFR.

	2013/14 Current Estimate £	**2014/15 Estimate £**	**2015/16 Estimate £**	**2016/17 Estimate £**
Capital Financing Requirement:				
Closing CFR	13,135,400	12,546,300	11,968,000	11,408,900
Movement in CFR	**+1,699,400**	**-589,100**	**-578,300**	**-559,100**
The movement on the CFR is represented by:				
Net financing need for the year	+2,234,700	0	0	0
Less Gross MRP	-535,300	-589,100	-578,300	-559,100
Movement in CFR	**+1,699,400**	**-589,100**	**-578,300**	**-559,100**

2.1.3 Minimum Revenue Provision (MRP) Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spending (CFR) each year by way of a minimum revenue provision (MRP). It is also allowed to make an additional voluntary revenue provision if it wishes (VRP).

CLG regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, but there must be "prudent provision". The guidance does not, however, define "prudent", instead making recommendations on the interpretation of the term.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent MRP, having had regard to the guidance and its own circumstances, the broad aim being to ensure that borrowing is repaid over a period that reflects the useful lives of the assets acquired. The Council is obliged to have regard to the CLG guidance, but it is not prescriptive. The Council is recommended to approve the following MRP Statement for 2014/15.

a. The Council will assess MRP in accordance with the recommendations within the guidance issued under section 21(1A) of the Local Government Act 2003.

b. Option 2, the CFR method, will be used for calculating MRP in respect of all capital expenditure incurred up to and including 31 March 2008. This is the simplest approach available, being calculated as a straightforward 4% of the relevant element of the CFR at the end of the previous year.

   This represents a change from the Council's previous use of Option 1, the regulatory method, which required the inclusion of the historic and somewhat controversial "adjustment A". Since adjustment A for Gedling was negative, this required MRP to be rather higher than otherwise necessary. The overall duty is merely for the authority to make prudent provision, and In the current economic climate the Chief Financial Officer considers that the use of Option 2 is prudent.

c. Option 3, the Asset Life Method, will be used for calculating MRP in respect of all capital expenditure incurred on and after 1 April 2008. An equal instalment approach will be adopted.

d. The Chief Financial Officer will determine estimated asset lives. Where expenditure of different types is involved, it will be grouped together in a manner which best reflects the nature of the main component of expenditure. It will only be divided up in cases where there are two or more major components, with significantly different asset lives.

e. Since April 2012 the Council has operated cash-backed Local Authority Mortgage Schemes (LAMS), each based on a five-year advance to Lloyds TSB to match the five-year life of the indemnity. Each advance placed with Lloyds provides an integral part of the mortgage lending, and is treated as capital expenditure, and a loan to a third party, therefore the Capital Financing Requirement (CFR) will increase by the amount of the advance. Each advance is to be returned at maturity and the funds will be classed as a capital receipt, and the CFR will reduce accordingly. As advances are temporary (5-year) arrangements, there is no need to set aside prudent provision to repay the debt liability in the interim period, and there is accordingly no MRP application.

f. In view of the economic climate and significant budgetary pressures, the Council will not provide for an additional voluntary contribution to MRP in 2014/15.

Based on the above policy, the net MRP charge for 2014/15 has been calculated as £587,800, as detailed below, and this sum has been included in the Council's 2014/15 budget proposals. The exact amount of MRP will be subject to change should capital financing decisions alter during the year.

	£
Option 2 – CFR Method	£271,100
Option 3 – Asset Life Method	£318,000
Gross MRP	**£589,100**
Funded by NCC-transferred debt	(£1,300)
Net MRP	**£587,800**

2.1.4 Affordability Prudential Indicators

The previous sections cover the overall "capital" and "control of borrowing" prudential indicators, but within this framework prudential indicators are required to assess the "affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The 2014/15 Capital Programme report, an item elsewhere on this agenda, provides full details of the proposed programme. The indicators, which can be found at Appendix 1, represent capital investment plans that are affordable, prudent and sustainable, and which have been fully factored into the Council's Medium Term Financial Plan.

a. Capital expenditure

b. Capital Financing Requirement

c. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. Estimates of financing costs include current commitments and the proposals in this budget report.

d. Incremental Impact of capital investment decisions on Council Tax -

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report, compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

e. Gross borrowing requirement and CFR

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for the year in question and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

2.2 Borrowing

The capital expenditure plans set out above provide details of the Council's service activity. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this activity. This will involve both the organisation of the cash flow and, where necessary, the organisation of approporiate borrowing facilities. The Treasury Strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual investment strategy.

2.2.1 Current portfolio position

The Council's projected treasury portfolio position at 31 March 2014, plus forward projections are summarised below. This shows the actual external debt, ie. the treasury management operations, against the underlying capital borrowing need, ie. the Capital Financing Requirement (CFR), highlighting any over or under borrowing.

Gross Debt & CFR	**2013/14 Current Estimate £000s**	**2014/15 Estimate £000s**	**2015/16 Estimate £000s**	**2016/17 Estimate £000s**
Debt 1 April	10,812	10,812	9,812	7,812
Change in debt in year	0	-1,000	-2,000	-1,000
Other long term liabilities	0	0	0	0
Gross Debt 31 March	**10,812**	**9,812**	**7,812**	**6,812**
Closing CFR	13,135	12,546	11,968	11,409
Under/(over) borrowing	2,323	2,734	4,156	4,597

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. To comply with the "gross debt" indicator, the Council must ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any **additional** CFR for 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Financial Officer can report that the Council has complied with this prudential indicator during the current year, 2013/14, and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Gross Debt & CFR	**2013/14 Current Estimate £000s**	**2014/15 Estimate £000s**	**2015/16 Estimate £000s**	**2016/17 Estimate £000s**
Opening CFR (closing CFR preceding year)	11,436	13,135	12,546	11,968
Additions in-year + following 2 years	1,699	0	383	1,297
Maximum Gross Debt	**13,135**	**13,135**	**12,929**	**13,265**
Est. debt at 31 March	10,812	9,812	7,812	6,812
Under/(over) borrowing	2,323	3,323	5,117	6,453

2.2.2 Treasury indicators – limits to borrowing activity

a. The Operational Boundary for external debt

This is the limit which external debt is not "normally" expected to exceed. In most cases, this would be a similar figure to the CFR, but it may be lower or higher depending on the levels of actual debt.

b. The Authorised Limit for external debt

This limit represents a control on the "maximum" level of borrowing. It is the statutory limit determined under s3 (1) of the Local Government Act 2003 and represents the limit beyond which external debt is prohibited. The Authorised Limit must be set, and revised if necessary, by Full Council. It reflects a level of external debt which, while not desirable, could be afforded in the short term, but is not sustainable in the longer term. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

2.2.3 Prospects for Interest Rates

The Council has appointed Capita Asset Services, Treasury Solutions (CASTS) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the CASTS central view and further information on interest rates can be found at Appendix 2.

Date	**Bank Rate %**	**PWLB Rates (including Certainty Rate adjustment)**		
		5 Year	**25 Year**	**50 Year**
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest in recent history, however growth rebounded during Q1 and Q2 of 2013 to surpass all expectations. Growth prospects remain strong looking forward, not only in the UK economy as a whole, but in all three main sectors ie. services, manufacturing and construction. One downside is that wage inflation remains significantly below CPI inflation so disposable income and living standards continue to be under pressure, although income tax cuts have ameliorated this to some extent.

The US faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to US growth.

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

- Although Eurozone concerns have subsided during 2013, Eurozone sovereign debt difficulties remain and there are major concerns as to how these will be managed over the next few years. In some countries levels of government debt continue to rise to levels that compound existing concerns and counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods.

- Investment returns are likely to remain relatively low during 2014/15 and beyond.

- Borrowing rates have risen during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years, however this must be carefully reviewed to avoid incurring even higher borrowing costs if new borrowing becomes unavoidable to finance new capital expenditure or to refinance maturing debt.

- 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.

2.2.4 Borrowing Strategy

a. The Strategy

The Council is currently maintaining an under-borrowed position (see 2.2.1 above). 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 represents "internal borrowing". This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US* *tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, 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 than they will be in the next few years.*

Any new borrowing will be discussed with CASTS, and any decisions will be reported to Cabinet at the next available opportunity.

b. Treasury management limits on activity

There are three debt related treasury activity limits, the purpose of which is to restrain the activity of the treasury function within agreed limits, thereby managing risk and reducing the impact of adverse movement in interest rates. However, if limits are set to be too restrictive they will impair opportunities to reduce costs or improve performance.

- An upper limit on fixed interest rate exposure. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments.

- An upper limit on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments.

  Members are asked to note that additional local indicators are also given for debt and investment individually, expressed as a percentage of the relevant totals.

- The 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.

2.2.5 Policy on borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely to profit from the investment of the extra sums borrowed, since this is illegal. Any decision to borrow in advance of need will be within the forward-approved CFR estimates, and will be considered carefully to ensure value for money can be demonstrated, and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need, the Council will ensure that there is a clear link between the capital programme and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of need. It will ensure that the on-going revenue liabilities created, and the implications for the future plans of and budgets have been considered, and evaluate the economic and market factors that might influence the manner and timing of any decision to borrow. The advantages and disadvantages of alternative forms of funding will be considered, together with the most appropriate periods over which to fund.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

2.2.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

Consideration will also be given to identifying 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.

All rescheduling will be reported to Cabinet at the earliest meeting following action.

2.2.7 Annual Investment Strategy 2014/15

The intention of the Annual Investment Strategy is to provide security of investment and minimisation of risk. The aim is to generate a list of highly creditworthy counterparties which will also enable divesification and thus the avoidance of concentration risk.

a. Investment Policy

The Council’s investment policy has regard to the CLG’s guidance on Local Government Investments (“the guidance”), and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”).

All investments will be made in sterling, and the Council’s general policy objective is the prudent investment of its treasury balances. The

Council's investment priorities are firstly the security of capital, secondly the liquidity of its investments, and thirdly the rate of return. The risk appetite of the Council is low, in order to give priority to the security of its investments.

The borrowing of monies purely to invest or on-lend and make a return remains unlawful, and the Council will not engage in such activity.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology uses the CASTS ratings service whereby banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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. This is fully integrated into the credit methodology provided by CASTS.

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.

The overall aim of the investment strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

Investment instruments identified for use in the financial year are listed at Appendix 4 under "Specified" and "Non-Specified" categories. An investment is a specified investment if all of the following apply:

- The investment is denominated in sterling and the payment or repayment is only payable in sterling.
- The investment is not a long-term investment, ie. it is made for less than one year.
- The making of the investment is not defined as capital expenditure.
- The investment is made with a body of high credit quality, or with the

UK government, a local authority or a parish council.

Only minimal reference need be given to specified investments in the Annual Investment Strategy, and they will generally be used for cash-flow management.

Non-specified investments are all those not meeting the criteria for specified investments. Accordingly, they may be simple investments made with the same counterparties as specified investments, being "non-specified" only by way of the maturity period being over one year. Alternatively they may be more complex instruments, or those offering slightly higher risk or lower liquidity. If used at all, non-specified investments will tend only to be used for the longer-term investment of core-balances.

Appendix 4 also sets out:

- Advantages and associated risk of investments under the non-specified category.
- The upper limit to be invested in each non-specified category.
- Those instruments best used after consultation with the Council's treasury advisers.

Counterparty investment limits will be as set out in the Council's Treasury Management Practices (Schedules).

b. Creditworthiness policy

The primary principles governing the Council's creditworthiness criteria are:

- Security of capital
- Liquidity of capital
- Return on investment

With regard to security, policies are maintained for the "categories" of investment to be used, and these are set out at Appendix 4, specified and non-specified investments. For the purpose of liquidity, policies are in place for determining the maximum periods for which funds may prudently be committed with counterparties.

The Chief Financial Officer maintains a "counterparty list" using rating information provided by CASTS, and this is monitored constantly. The CFO has delegated authority to amend the minimum criteria as he sees fit, and will report any such amendments to Cabinet for information as necessary. The minimum criteria the Council will use in selecting its counterparties are currently based on based on Fitch ratings of:

- Short term rating of F1
- Long term rating of A
- Viability rating of BBB
- Support rating of 1

In addition, the Council makes use of the creditworthiness service provided by CASTS. This employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies. Credit ratings are supplemented with "overlays" as follows:

- credit watches and credit outlooks from credit rating agencies.
- CDS (credit default swaps) spreads to give early warning of likely changes in credit ratings.
- sovereign ratings to select counterparties from only the most creditworthy countries.

The CASTS approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested maximum durations for its investments with a counterparty meeting the minimum rating criteria.

- Yellow: 5 years (AAA rated Government debt or its equivalent)
- Purple: 2 years
- Blue: 1 year (nationalised or semi nationalised UK banks)
- Orange: 1 year
- Red: 6 months
- Green: 100 days
- No colour: not to be used

The creditworthiness service uses a wider array of information than just primary ratings, and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

All credit ratings are monitored weekly and the Council is alerted to changes to ratings of all three agencies through its use of the CASTS creditworthiness service. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use for new investment will be withdrawn immediately.

Sole reliance will not be placed on the use of the CASTS external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA minus. Appendix 5 sets out the countries currently meeting the criteria for investment by the Council. However, for some time the CFO has adopted a policy to lend only to UK registered institutions, and this is expected to continue for 2014/15. The UK currently has an AA+ sovereign rating.

Given the extreme volatility of market conditions, this policy will of course be subject to on-going review by the CFO, in conjunction with advice from CASTS. The list will be added to, or deducted from, by officers should ratings change in accordance with this policy

Under the cash-backed Local Authority Mortgage Scheme, launched in April 2012, the Council has made two advances of £1m each to Lloyds Banking Group, each for a period of five years, to match the life of the indemnities. These are classified as "service investments", rather than treasury management investments, and are therefore <u>outside</u> the Specified/Non specified categories discussed above.

c. Investment Strategy

The Council's in-house managed funds are mainly cash-flow derived however, there has for some time been a core balance available for investment over a 2-3 year period, if appropriate. In addition, any borrowing undertaken in advance of need at favourable interest rates may add to the funds available.

Investments will be made with careful reference to any remaining core balance, to cash-flow requirements, and to the outlook for short-term interest rates (ie. for investments up to 12 months).

Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends are:

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

There are upside risks to these forecasts (ie. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment continues to fall faster than expected. However, should the pace of growth fall back there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

CASTS' suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.00%
- 2017/18 2.00%

As a result of fixed investments already secured, the Council's outturn equated rate for 2013/14 is expected to be around 1.14%, and the budgeted equated return for 2014/15 is 0.83%, both in excess of the suggested returns above.

An investment treasury indicator and limit must be set for the maximum principal funds invested for periods in excess of 364 days in the forthcoming and two subsequent years (ie. new non-specified investments). The limit for each year is set with regard to the Council's liquidity requirements.

The limit for new non-specified investments in each of 2014/15, 2015/16 and 2016/17 is £3m, subject always to the overall limit for total non-specified investments held at any one time indicated at Appendix 4.

d. Investments defined as capital expenditure

The acquisition of share capital or loan capital in a body corporate is defined as capital expenditure under regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded out of capital or revenue resources, and will be classified as non-specified investments.

Investments in "money market funds", which are collective investment schemes, and bonds issued by "multilateral development banks", both defined in SI 2004 No 534, will not be treated as capital expenditure.

A loan or grant or financial assistance by this Council to another body for capital expenditure by that body will be treated as capital expenditure.

e. Provision for credit-related loss

If any of the Council's investments appear to be at risk of loss due to default, this is a "credit-related loss" and not a loss resulting from a fall in price due to movements in interest rates. In such an instance, the Council will make revenue provision of an appropriate amount.

f. End of Year Investment Report

At the end of the year, the Council will report on its investment activity as part of its Annual Treasury Report.

g. Policy on the use of external service providers

The Council uses CASTS as its external treasury management advisers, however it recognises that responsibility for treasury management decisions remains with the organisation at all times, and will ensure that undue reliance is not placed upon external service providers.

The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review

2.2.8 Gedling Borough Council scheme of delegation

Full Council is responsible for:

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of the annual strategy (TMSS)
- Annual budget approval

Cabinet is responsible for:

- Approval of/amendments to the Council's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and virement approval
- Approval of the division of responsibilities
- Receiving and reviewing regular Treasury Management monitoring reports, and acting on recommendations
- Approving the selection of external service providers and agreeing terms of appointment.

Audit Committee is responsible for:

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

2.2.9 The role of the section 151 officer

The Chief Financial Officer is the Council's nominated S151 Officer. The role of the S151 (responsible) officer includes the following:

- Recommending clauses, treasury management policy/practices for approval, reviewing these regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing management information reports
- Reviewing the performance of the treasury management function
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- Ensuring the adequacy of internal audit, and liaising with external audit
- The appointment of external service providers

Alternative Options

There are no alternative options, this report being a statutory requirement.

Financial Implications

No specific financial implications are attributable to this report.

Appendices

1. Prudential and Treasury indicators for 2014/15 to 2016/17
2. Interest rate forecasts
3. Economic background
4. Specified and non-specified Investments
5. Approved countries for investment

Background Papers

None identified.

Recommendation

That:

Members note the Prudential Indicators and Treasury Strategy 2014/15 as detailed in the report, and refer it to Full Council for approval as required by the regulations.

Reasons for Recommendations

To comply with the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP guidance, the CIPFA Treasury Management Code and CLG investment guidance.

For more information, please contact:

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