

# **Treasury Management Strategy Statement** Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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2016/17

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# 1. Introduction

## 1.1 Background

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

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

CIPFA defines treasury management as:

*"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

## 1.2 Reporting requirements

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

**Prudential and Treasury Indicators and Treasury Strategy** (This report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision 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; and
- an investment strategy (the parameters on how investments are to be managed).

**A Mid Year Treasury Management Report:** This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury function is meeting the strategy or whether any policies require revision.

**An 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.

### Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Financial Policy Panel for the mid year report and Strategy & Resources Committee for the Annual Treasury Management report.

### **1.3 Treasury Management Strategy for 2016/17**

The strategy for 2016/17 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 will 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; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the 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 responsible for scrutiny. When reporting the interim treasury management performance for the financial year members of Financial Policy Panel receive a presentation from either the Council's treasury management advisors or its external fund manager, further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

### **1.5 Policy on the use of external service providers**

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

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 our external service providers.

It 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. The Capital Prudential Indicators 2016/17 – 2018/19

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' overview and confirm capital expenditure plans.

**Capital Expenditure:** This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts. The table below summarises the capital expenditure forecasts and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Capital Expenditure	3,485	5,534	1,031	1,093	386
<b>Financed by:</b>					
Capital receipts & reserves	612	1,921	695	779	100
Capital grants	245	291	286	286	286
Other contribution	757	3,077	0	0	0
Revenue	1,871	245	50	28	0
<b>Net financing need for the year</b>	<b>3,485</b>	<b>5,534</b>	<b>1,031</b>	<b>1,093</b>	<b>386</b>

### The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply 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 above, which has not immediately been paid for, will increase the CFR.

The Council is asked to approve the CFR projections below:

	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
<b>Capital Financing Requirement</b>					
CFR – non housing	nil	Nil	nil	nil	nil
<b>Total CFR</b>	<b>nil</b>	<b>Nil</b>	<b>nil</b>	<b>nil</b>	<b>nil</b>
<b>Movement in CFR</b>	<b>nil</b>	<b>Nil</b>	<b>nil</b>	<b>nil</b>	<b>nil</b>

**MRP Policy Statement**

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

The CFR for the Council over the next three years is zero; this means that the Council does not have a requirement to make MRP to the General Fund.

**Core funds and expected investment balances**

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

<b>Year End Resources</b>	<b>2014/15 Actual £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>	<b>2017/18 Estimate £'000</b>	<b>2018/19 Estimate £'000</b>
Fund balances/reserves	3,333	2,933	2,933	2,933	2,933
Capital receipts	4,082	3,421	2,726	1,947	1,847
Earmarked reserves	6,342	6,753	5,153	5,153	5,153
Other	3,776	5,000	4,000	4,000	4,000
<b>Total core funds</b>	<b>17,533</b>	<b>18,107</b>	<b>14,812</b>	<b>14,033</b>	<b>13,933</b>
Working capital *	<b>3,847</b>	<b>4,500</b>	<b>4,000</b>	<b>4,000</b>	<b>4,000</b>
<b>Expected investments</b>	<b>21,380</b>	<b>22,607</b>	<b>18,812</b>	<b>18,033</b>	<b>17,933</b>

\* Working capital balances shown are estimated year end; these may be higher mid-year

**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 Council is asked to approve the following indicators:

**Actual and estimates of the 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.

	<b>2014/15 Actual %</b>	<b>2015/16 Estimate %</b>	<b>2016/17 Estimate %</b>	<b>2017/18 Estimate %</b>	<b>2018/19 Estimate %</b>
Ratio	-2	-2	-1	-1	-2

The estimates of financing costs include current commitments and the proposals in this budget report.

**Estimates of the 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.

**Incremental impact of capital investment decisions on the band D council tax**

	2014/15 Actual %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
<b>Council tax - Band D</b>	1	3	1	1	0

### 3. Treasury Management Strategy

The capital expenditure plans set out in Section 2 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 the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

#### 3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below.

	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
<b>Actual debt at 31 March</b>	nil	nil	nil	nil	nil
<b>The Capital Financing Requirement</b>	nil	nil	nil	nil	nil

<b>Total investments at 31 March</b>					
Investments	21,380	22,607	18,812	18,033	17,933
Investment change		+ 1,227	- 3,795	- 779	- 100

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to 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 2016/17 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 Director of Finance and Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

### 3.2 Treasury Indicators: Limits to Borrowing Activity

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

Operational boundary	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Debt	0.0	0.0	0.0	0.0
Other long term liabilities	0.0	0.0	0.0	0.0
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**The Authorised Limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited and this limit needs to be set or revised by the full Council. It reflects the level of external debt, which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. 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. The Council is asked to approve the following Authorised Limit:

Authorised limit	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	0	0	0	0
Total	5,000	5,000	5,000	5,000

### 3.3 Prospects for Interest Rates

The Council has appointed Capita Asset Services 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 our central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Q1 2016	0.50	1.70	3.20	3.00
Q2 2016	0.50	1.90	3.20	3.00
Q3 2016	0.50	2.00	3.30	3.10
Q4 2016	0.50	2.10	3.30	3.10
Q1 2017	0.75	2.20	3.50	3.30
Q2 2017	0.75	2.30	3.50	3.30

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Q3 2017	1.00	2.40	3.60	3.40
Q4 2017	1.00	2.60	3.60	3.40

**UK.** 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 although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2.2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3 followed by a slight recovery in quarter 4 to an initial reading of +0.5%. The February Bank of England Inflation Report included a forecast for growth to remain around 2.2% – 2.4% 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 at the same time that CPI inflation has fallen to, or near to, zero since February 2015. However, these forecasts are approximately 0.2% lower than those of the November Inflation Report. Investment expenditure is also expected to support growth. However, since the second half of 2015, most worldwide economic statistics have been weak and financial markets have been particularly volatile in early 2016. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK and this theme was maintained in the February Inflation Report.

The February Inflation Report was notably subdued in respect of the forecasts for inflation in the near-term; this was expected to barely get back up to the 1% level within the next 12 months but was expected to marginally exceed the 2% target on the 2-3 year time horizon. The increase in the November Inflation Report 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. 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 MPC will decide to make a start on increasing Bank Rate. There is also the uncertain impact of the EU referendum which may take place as early as June 2016.

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 1 of 2017. There is downside risk to this forecast i.e. it could be pushed further back and the markets are currently betting on a quarter 1 2018 increase.

**USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3 and retreated to +0.7% in quarter 4. However, the uninterrupted run of strong monthly increases in non-farm payrolls figures for growth in employment in 2015 prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**EZ.** In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and



other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. 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%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout 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 bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing 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.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly 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 phenomenally 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 authorities will not be able to avoid new borrowing to finance new capital expenditure and/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.

### **3.4 Borrowing Strategy 2016/17 – 2018/19**

The Council does not envisage any borrowing need during the period of planning shown in this report.

## 4. Annual Investment Strategy

### *Investment Policy*

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.

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.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As with previous practice, ratings will 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.

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

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in [Appendix 2](#) under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

### *Creditworthiness policy*

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 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 below; 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.**

The Director of Finance and Resources 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 types of investment instrument are either Specified or Non-Specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Capita Asset Services, our treasury consultants, 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 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

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

- Banks 1 - good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA

and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

- i. Short term – *F1*
  - ii. Long term – *A-*
  - iii. Viability / financial strength – *C* (Fitch / Moody's only)
  - iv. Support – *3* (Fitch only)
- Banks 2 – Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building societies - The Council will *use* all societies which:
  - i. meet the ratings for banks outlined above;
  - ii. Have assets in excess of £1bn (or are both)
- Money Market Funds – AAA
- Enhanced money market funds (EMMFs) with a risk score of 1.5
- UK Government (including gilts and the Debt Management Account Deposit Fund)
- Local authorities, parish councils etc
- Supranational institutions
- Pooled property funds – up to £2.5m

A limit of 50% will be applied to the use of Non-Specified investments.

**Country and sector considerations:-** Due care will be taken to consider the country, group and sector exposure of the Council's investments.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch . The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

No minimum credit rating applies to the UK.

- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness

**Use of additional information other than credit ratings:** Additional requirements under the Code 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.

**Time and monetary limits applying to investments:** 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):

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
<b>Banks 1 category high quality</b>	<b>F1 / AAA / B / 1</b>	<b>£2.5m</b>	<b>5yrs</b>
<b>Banks 1 category medium quality</b>	<b>F1 / AA- / B / 2</b>	<b>£2.5m</b>	<b>3yrs</b>
<b>Banks 1 category lower quality</b>	<b>F1 / A- / C / 3</b>	<b>£2.5m</b>	<b>1yr</b>
<b>Banks 2 category – part nationalised</b>	<b>N/A</b>	<b>£2.5m</b>	<b>1yr</b>

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Limit 3 category – Council’s banker (not meeting Banks 1)	N/A	£2.5m	1 day
DMADF	AAA	£2.5m	6 months
Local authorities	N/A	£2.5m	1yr
Money market Funds	AAA	£2.5m	liquid
Enhanced money market funds with a credit score of 1.5	AAA	£2.5m	liquid

The proposed criteria for Specified and Non-Specified investments are shown in Appendix 4 for approval.

**Investment Strategy**

**In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

**Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2017. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

- 2016/17 0.60%
- 2017/18 1.25%
- 2018/19 1.75%
- 2019/20 2.00%
- 2020/21 2.25%
- 2021/22 2.50%
- 2022/23 2.75%
- 2023/24 2.75%
- Later years 3.00%

The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

**Investment treasury indicator and limit:** total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

<b>Maximum principal sums invested &gt; 364 days</b>			
	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Principal sums invested > 364 days	8.0	8.0	8.0

For its cash flow generated balances, the Council will seek to utilise interest bearing accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

#### **4.1 End of year investment report**

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

#### **4.2 External fund managers**

Around £20m of the Council's funds are externally managed on a discretionary basis by Aberdeen Asset Management.

The Council's external fund manager(s) will comply with the Annual Investment Strategy. The agreement(s) between the Council and the fund manager(s) additionally stipulate guidelines and duration and other limits in order to contain and control risk.

The minimum credit criteria to be used by the cash fund manager(s) are as follows: -

	<b>Fitch</b>	<b>Moodys</b>	<b>Standard and Poors</b>
<b>Long term</b>	A-	A2	A
<b>Short term</b>	F1	P1	A-1

The fund manager's view on interest rates and opportunities for gilts / bonds is as follows:

Markets have been in turmoil following the year end, although there has been some respite in more recent weeks. The last two months have been about policy deliberation setting the tone for further divergent central bank action, as the global backdrop deteriorated. Aside from the Federal Reserve raising rates in December, sentiment has turned dovish across most other central banks, in particular the ECB, BoJ and more importantly the MPC.

The Monetary Policy Committee (MPC) is now firmly on hold citing both weaker domestic and global growth. The further deterioration in the price of oil is now likely to lead to a more subdued rise in inflation than the committee was originally predicting in the November Inflation Report. Recent economic data has generally been disappointing, with industrial production also falling. Combined with uncertainty over the EU referendum, this means market pricing of rate hikes has been pushed out into 2017. Recent comments from the MPC have cited wage growth being weaker with labour costs rising less than expected which for now warrants a more cautious

approach, and that there is little tolerance for further downside surprises which would suggest that some members may even consider rates may need to be cut further.

In review the fund performance has been at the lower end of expectations, credit spread widening was very much a theme last year which added some volatility to the funds ABS exposure in the second half, although the overall positioning of the fund remained defensive. Increases were made to the floating rate note exposure in both senior and covered bonds in anticipation of yields trending higher particularly with expectations of an earlier US rate rise. We have adjusted some of our ABS exposure to shorter WAL assets as well as reducing both credit card and auto loan exposure preferring more stable MBS assets. More recently we have been looking to add 3 year senior floating rate notes and covered bond issuance for some yield carry, although we have been adding to our fixed rate ABS assets where there has been value over other assets.

Looking through 2016, it will be very much a case of seeking out value opportunities across all asset classes in order to meet our return expectations, which remain conservative but are in line with last year at 0.70%-0.90% on a gross basis. Our return target is based on our central case that rates are not likely to rise before Q2 2017.

## Appendices

1. Economic background
2. Treasury Management practices
3. The treasury management role of the section 151 officer



## APPENDIX 1: Economic Background

### THE UK ECONOMY

UK GDP growth rates of 2.2% in 2013 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 although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2.2%. Quarter 1 2015 was weak at +0.4% (+2.9% y/y), although there was a slight increase in quarter 2 to +0.5% before weakening again to +0.4% (+2.1% y/y) in quarter 3 and then picking up to +0.5% (2.2%) in quarter 4.

The Bank of England's February Inflation Report included a forecast for growth to remain around 2.2% – 2.4% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

Since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK. Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time, (as he confirmed in a speech on 19 January):

- *Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short.*
- *Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 @ 1.2%. December 2015 saw a slight increase to 1.4%.*
- *Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.*

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y/y. The November 2015 Inflation Report was notably subdued in respect of the forecasts for CPI 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 it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. According to the February 2016 Inflation Report, CPI inflation is now expected to get back to around 1% by the end of 2016 but not get near to 2% until the latter part of 2017.

However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran, enabling it to sell oil freely into international markets, there could well be some further

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falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30%, (or more), over the last year. These developments have led to the Bank of England lowering the pace of increases in inflation in its February 2016 Inflation Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation; however, it could also result in a decrease in employment so the overall inflationary impact may be muted. For now, the Bank of England is forecasting further falls in unemployment to circa 4.8%.

Confidence is another big issue to factor into forecasting. Recent volatility in financial markets could dampen investment decision making as corporates take a more cautious view of prospects in the coming years due to international risks. This could also impact in a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries, so this could well feed through into an increase in consumer expenditure and demand in the UK economy, (a silver lining!). Another silver lining is that the UK may not be affected as much as some other western countries by a slowdown in demand from emerging countries, as the EU and US are our major trading partners.

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 MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that rates ought to rise sooner and quicker, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would aggressively raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q1 2017. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, perhaps as early as June, rather than in 2017; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

## **THE GLOBAL ECONOMY**

**USA.** GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.0% in Q3 and then retreating to +0.7% in Q4.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong (and December was outstanding); this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**The Eurozone (EZ).** In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. The initial reading for Q4 is 0.3% also. 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%.

**Greece.** During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although 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 initial 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 a Greek exit from the euro may only have been delayed by this latest bailout.

**Portugal and Spain.** The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. A left wing / communist anti-austerity coalition has won a majority of seats in Portugal. 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.

**China and Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 and the start of 2016 in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality to bond markets. In

addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

**Emerging countries.** There are also considerable concerns about the vulnerability of some emerging countries, and their corporates, which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis, (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries), there is now a strong flow back to those western economies with strong growth and a path of rising interest rates and bond yields.

The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed by a simultaneous downturn in demand for their exports and a deterioration in the value of their currencies. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

## **CAPITA ASSET SERVICES FORWARD VIEW**

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services undertook its last review of interest rate forecasts on 12 February 2016. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2017.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. At some future point in time, an increase in investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in February 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 1 2018.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a flight to safe havens
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and USA resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU. The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

## APPENDIX 2: EPSOM & EWELL BOROUGH COUNCIL TREASURY MANAGEMENT PRACTICES

### TMP1 Credit and Counterparty Risk Management

#### General statement

The Director of Finance and Resources will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/ suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 *Reporting requirements and management information arrangements*. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

#### [1] Credit and Counterparty Risk Management

Credit and counter-party risk is the risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, capital project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.

Epsom & Ewell Borough Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 Approved Instruments Methods and Techniques and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations with whom it may enter into other financing arrangements.

Epsom & Ewell Borough Council will ensure it has adequate though not excessive cash resources, overdraft 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.

#### [2] Interest Rate & Inflation Risk Management

Epsom & Ewell Borough Council will manage its exposure to fluctuations in interest rates with a view to containing its interest cost, or security its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 *Reporting requirements and management information arrangements*.

The effects of varying levels of inflation, insofar as they can be identified as impacting directly on its treasury management activities, will be controlled by the Council as an integral part of its strategy for managing its overall exposure to inflation.

It will achieve these objectives by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates or

inflation. The above are subject at all times to the consideration and, if required, approval of any policy or budgetary implications.

### **[3] Credit and Counterparty Risk Management**

Epsom & Ewell Borough Council regards a prime objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investments activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments, methods and techniques* and listed in the Treasury Management Strategy. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations with whom it may enter other financing arrangements.”

### **[4] Legal and Regulatory Risk Management**

Epsom & Ewell Borough Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1 [3] *credit and counterparty risk management*, it will ensure that there is evidence of counterparties’ powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

This Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation”.

### **[5] Fraud, Error and Corruption, and Contingency Management**

Epsom & Ewell Borough Council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.”

### **[6] Market Risk Management**

Epsom & Ewell Borough Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

The CLG issued Investment Guidance in 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 operate 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-Sectoral Guidance Notes. This Council adopted the revised Code at the Strategy & Resources meeting on 30 March 2010 and applies its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its Treasury Management Practices (TMPs). This part, TMP 1(3), 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 that 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:

**Strategy Guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

**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 Account deposit facility, UK Treasury Bills or a 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. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor’s, Moody’s or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building). For category 5 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. This criterion is:

	<b>Fitch (or equivalent)</b>	<b>Moody’s</b>	<b>Standard &amp; Poors</b>	<b>Money Limit</b>	<b>Time Limit</b>
Upper Limit Category	F1 / AAA / B / 1	P-1 / Aaa / B	A-1 / AAA	£2.5m	5yrs
Middle Limit Category	F1 / AA- / B / 2	P-1 / Aa3/ B	A-1 / AA-	£2.5m	3yrs



	Fitch (or equivalent)	Moody's	Standard & Poors	Money Limit	Time Limit
Lower Limit Category	F1 / A- / C / 3	P-1 / A3 / C	A-1 / A	£2.5m	1yrs
Building Society	Meet banks criteria or assets in excess of £1bn and are an 'eligible institution'			£2.5m	9 months
DMADF	AAA			£2.5m	6 months
Money Market Funds	AAA			£2.5m	no limit
Enhanced Money Market Funds				£2.5m	no limit
Other Local Authorities				£2.5m	1yr
Supranational				£2.5m	5yrs
Gilts				£2.5m	10yrs
Guaranteed Organisations				£2.5m	length of guarantee

**Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	<p><b>Supranational Bonds greater than 1 year to maturity</b></p> <p><b>(a) Multilateral development bank bonds</b> - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.).</p> <p><b>(b) A financial institution that is guaranteed by the United Kingdom Government</b> (e.g. The Guaranteed Export Finance Company {GEFCO})</p> <p>The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	<p>50% of money invested through external fund manager. Restriction of 5yrs maximum maturity</p> <p>50% of money invested through external fund manager. Restriction of 5yrs maximum maturity</p>
b.	<p><b>Gilt edged securities</b> with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	<p>50% of money invested through external fund manager. Restriction of 10yrs maximum maturity</p>

	<b>Non Specified Investment Category</b>	<b>Limit (£ or %)</b>
c.	<b><i>The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.</i></b>	In this instance balances will be minimised as far as is possible.
d.	<b>Building societies not meeting the basic security requirements under the specified investments.</b> The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and have a minimum asset size of £1bn, but will restrict these type of investments to 12 months	£2.5m per institution
e.	Any <b>bank or building society</b> that has a minimum long term credit rating of A-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum of 50% on investments over 1yr
f.	Any <b>non rated subsidiary</b> of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to the parent bank having the necessary ratings outlined in (e) above and a guarantee from the parent company.	£2.5m per institution
g.	<b>Share capital or loan capital*</b> in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. There is a higher risk of loss with these types of instruments. .	Maximum £2.5m per institution, subject to minimum rating of AA- (long term)
h.	<b>Pooled property funds</b> – The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	Maximum £2.5m per fund

Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. This criterion is outlined in the tables above.

In respect of category g , this will only be considered after obtaining external advice and subsequent Member approval.

**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 Director of Finance and Resources, and if required new counterparties which meet the criteria will be added to the list.

**Use of External Fund Managers** – It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council's investment

strategy. The terms of the fund managers' investment policies are in accordance with strategy detailed above and are detailed in the contract with the fund manager. The performance of the manager is reviewed at least annually by the Director of Finance and Resources and the manager is contractually required to comply with the annual investment strategy.

## **TMP2 Performance measurement**

The Council has a number of approaches to evaluating treasury management decisions: -

- a. Monthly reviews carried out by the treasury management team
- b. Reviews with our treasury management consultants & external fund manager
- c. Annual review after the end of the year as reported to Strategy & Resources Committee
- d. Half yearly monitoring report to Financial Policy Panel
- e. Quarterly monitoring reports

The treasury management team holds reviews with our consultants every 6 months to review the performance of the investment and debt portfolios.

An Annual Treasury Report is submitted to the Council each year after the close of the financial year which reviews the performance of the investment portfolio. This report contains the following: -

- a. average investments held during the financial year and average interest rates
- b. investment strategy for the year compared to actual strategy
- c. explanations for variance between original strategies and actual
- d. comparison of return on investments to the investment benchmark
- e. compliance with Prudential and Treasury Indicators

The performance of investment earnings will be measured against the following benchmarks: -

- a. In house investments  
7 day LIBID
- b. External fund manager  
7 day LIBID

Epsom & Ewell Borough Council's policy is to appoint external investment fund managers to manage a proportion of its cash and will comply with the Local Authorities (Contracting Out of Investment Functions) Order 1996 [SI 1996 No 1883].

The delegation of investment management to external managers will entail the following:

- Formal contractual documentation;
- Agreement on terms for early termination of the contract;
- Setting of investment instruments, constraints/parameters/conditions

- Setting of investment counterparty limits;
- Setting a performance measurement benchmark and a performance target;
- Frequency of performance reporting;
- Frequency of meetings with investment managers;

The Code of Practice places an obligation on the Council to monitor the performance of the fund managers. This Council has appointed Capita Asset Services to assist in this respect.

### **TMP3 Decision – making and analysis**

Epsom & Ewell Borough Council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the scheduled to this document.”

The Treasury team will ensure that the following records will be retained: -

- Daily cash balance forecasts
- Money market rates obtained by telephone from brokers
- Dealing slips for all money market transactions
- Brokers' confirmations for investment transactions
- Confirmations from borrowing institutions where deals are done directly
- Contract notes received from fund manager
- Fund manager valuation statements

Processes to be pursued:

- Cash flow analysis
- Investment maturity analysis
- Ledger reconciliation
- Performance management information

### **TMP4 Approved instruments, methods and techniques**

Epsom & Ewell Borough Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the Treasury Management Strategy and within the limits and parameters defined.

## TMP5 Organisation, clarity and segregation of responsibilities and dealing arrangements

### Allocation of responsibilities

**(i) Full council**

- approval of annual strategy.

**(ii) Strategy & Resources Committee**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing annual monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

**(iii) Financial Policy Panel**

- receiving and reviewing half yearly monitoring report and acting on recommendations

**(iv) Director of Finance and Resources**

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

### Principles and Practices Concerning Segregation of Duties

The following duties must be undertaken by separate officers: -

Dealing	Negotiation and approval of deal. (Dealer 1) Production of transfer note. (Dealer 1)
Bank	Entry of transaction onto bank (Finance Officer)
Authorisation/Payment of Deal	Approval and payment. (Dealer 2)
Accounting Entry	Processing of accounting entry (Exchequer Team) Reconciliation of cash control account. (Exchequer Team)
Bank	Bank reconciliation (Exchequer Team)

**Statement of the treasury management duties/responsibilities of each treasury post**

**The responsible officer**

The responsible officer is the person charged with professional responsibility for the treasury management function and in this Council is the Director of Finance and Resources. This person will carry out the following duties: -

- recommending clauses, treasury management policy/practices for approval, reviewing the same 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
- recommending the appointment of external service providers.
- The responsible officer has delegated powers through this policy to take the most appropriate form of borrowing from the approved sources, and to make the most appropriate form of investments in approved instruments.
- The responsible officer may delegate his power to borrow and invest to members of his staff. The Treasury Management Team must conduct all dealing transactions, or staff authorised by the responsible officer to act as temporary cover for leave/sickness.
- The responsible officer will ensure that Treasury Management Policy is adhered to, and if not will bring the matter to the attention of elected members as soon as possible.
- Prior to entering into any capital financing, lending or investment transaction, it is the responsibility of the responsible officer to be satisfied, by reference to the Council's legal department and external advisors as appropriate, that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations
- It is also the responsibility of the responsible officer to ensure that the Council complies with the requirements of The Non-Investment Products Code (formerly known as The London Code of Conduct) for principals and broking firms in the wholesale markets.

**The Head of Financial services**

The responsibilities of this post will be: -

- a) execution of transactions
- b) adherence to agreed policies and practices on a day-to-day basis
- c) maintaining relationships with counterparties and external service providers
- d) supervising treasury management staff
- e) monitoring performance on a day-to-day basis
- f) submitting management information reports to the responsible officer
- g) identifying and recommending opportunities for improved practices

**The Head of the Paid Service – the Chief Executive**

The responsibilities of this post will be: -

- a) Ensuring that the system is specified and implemented
- b) Ensuring that the responsible officer reports regularly on treasury policy, activity and performance.

**The Monitoring Officer – the Head of Legal Services**

The responsibilities of this post will be: -

- a) Ensuring compliance by the responsible officer with the treasury management policy statement and treasury management practices and that they comply with the law.
- b) Being satisfied that any proposal to vary treasury policy or practice complies with law or any code of practice.
- c) Giving advice to the responsible officer when advice is sought.

**Internal Audit**

The responsibilities of Internal Audit will be: -

- a) Reviewing compliance with approved policy and treasury management practices.
- b) Reviewing division of duties and operational practice.
- c) Assessing value for money from treasury activities.
- d) Undertaking probity audit of treasury function.

**Absence Cover Arrangements**

Six officers within the Finance Team have the authority to place deals, with a further two officers able to input trades onto the system ready for authorisation.

## **Dealing**

The following posts are authorised to deal: -

- Head of Financial Services
- Chief Accountant
- 3 Senior Accountants
- Accountant

## **TMP6 Reporting requirements and management information arrangements**

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

As a minimum, the council will receive:

- an annual report on the strategy and plan to be pursued in the coming year.
- a mid-year review on the current performance of the treasury management function.
- an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation's treasury management policy statement and TMPs.

## **TMP7 Budgeting, accounting and audit arrangements**

The Director of Finance and Resources will prepare, and Epsom & Ewell Borough Council will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management functions, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 *Risk management*, TMP2 *Best value and performance measurement*, and TMP4 *Approved instruments, methods and techniques*. The responsible officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 *Reporting requirements and management information arrangement*.

Epsom & Ewell Borough Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

Epsom & Ewell Borough Council will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.



## **TMP8 Cash and cash flow management**

Cash flow projections are prepared annually and updated daily. The annual cash flow projections are prepared from the previous years' cash flow records, adjusted for known changes in levels of income and expenditure and also changes in payments and receipts dates. These details are supplemented on an ongoing basis by information received of new or revised amounts to be paid or received as and when they are known.

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this organisation will be under the control of the Director of Finance and Resources, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the responsible officer will ensure that these are adequate for the purposes of monitoring.

## **TMP9 Money Laundering**

Epsom & Ewell Borough Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained.

## **TMP10 Staff training and qualifications**

The Council recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: -

- a) Treasury management staff employed by the Council
- b) Members charged with governance of the treasury management function

All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. The Council operates a Personal Development Review system which identifies the training requirements of individual members of staff engaged on treasury related activities.

Additionally, training may also be provided on the job and it will be the responsibility of the Director of Finance and Resources to ensure that all staff under his authority receive the level of training appropriate to their duties. This will also apply to those staff who from time to time cover for absences from the treasury management team.

### **Details of Approved Training Courses**

Treasury management staff and members will go on courses provided by our treasury management consultants, CIPFA, money brokers etc.

### **Statement of Professional Practice (SOPP)**

1. Where the Chief Financial Officer is a member of CIPFA, there is a professional need for the CFO to be seen to be committed to professional responsibilities through both personal compliance and by ensuring that relevant staff are appropriately trained.
2. Other staff involved in treasury management activities who are members of CIPFA must also comply with the SOPP.

### **Members charged with governance**

Members charged with diligence also have a personal responsibility to ensure that they have the appropriate skills and training for their role.

### **TMP11 Use of external service providers**

Epsom & Ewell Borough Council recognises the potential value of employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which will have been submitted to a full evaluation of the costs and benefits. It will also 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. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid overreliance on one or a small number of companies.

### **TMP12 Corporate governance**

Epsom & Ewell Borough Council is committed to the principle of openness and transparency in its treasury management function and in all of its functions.

It has adopted the CIPFA Code of Practice on Treasury Management and implemented key recommendations on developing Treasury Management Practices, formulating a Treasury Management Policy Statement and implementing the other principles of the Code.

The following documents are available for public inspection: -

Treasury Management Policy Statement

Treasury Management Strategy Statement

Annual Investment Strategy

Minimum Revenue provision policy statement

Annual Treasury Review Report

Treasury Management monitoring reports (e.g. half yearly, quarterly)

Annual accounts and financial instruments disclosure notes

Annual budget

3 Year Capital Plan

Minutes of Council / committee meetings

## APPENDIX 3:

### Approved countries for investments

#### AAA

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

#### AA+

- U.K.

## APPENDIX 4:

### The treasury management role of the section 151 officer

#### The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same 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;
- recommending the appointment of external service providers.