Appendix 1

Local Government Treasury Management Definitions

- **Investment**

  In the context of a local authority cash deposit, an investment is a monetary asset deposited with a credible institution with the objective of providing income in the future. This is a transaction which relies upon the power in section 12 of the 2003 Act and is recorded in the balance sheet under the heading of investments within current assets or long-term investments.

- **Long-term Investment**

  This is any investment other than one which is contractually committed to be paid within 12 months of the date on which the investment was made.

- **Credit Rating Agency**

  An independent company that provides investors with assessments of an investment's risk and the three most prominent are.

  Standard and Poor's (S & P)
  Moody's Investors Service Limited (Moody's)
  Fitch Ratings Limited (Fitch)

- **Specified Investment**

  An investment is a specified investment if it satisfies the following conditions:

  1. The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.

  2. The investment is not a long-term investment (as defined above).

  3. The investment is not considered to be capital expenditure.

  4. One or both of the following conditions is both:

     - The investment is made with the UK Government or a local authority (as defined in section 23 of the 2003 Act) or local authorities in Scotland and Northern Ireland or a parish or community council.

     - The investment is made with a body or in an investment scheme which has been awarded a high credit rating by a credit rating agency

  5. The principal sum to be repaid at maturity is the same as the initial sum invested other than investments in the UK Government.

- **Non-specified Investments**

  These are investments, which do not meet the conditions of specified investments.

Appendix 2

Interest Rate Forecasts

Bank Rate (Forecasts as at 31/12/2014 and subject to change)

	Arlingclose (Central case)
2015/2016 - Q1	0.50%
Q2	0.50%
Q3	0.75%
Q4	0.75%
2016/2017	1.00%
2017/2018	1.50%

PWLB (Forecasts as at 31/12/2014 and subject to change- Source Arlingclose (Central case)

	Q1 – 2015/2016	**Q2 – 2015/2016**	**Q3 – 2015/2016**	**Q4 – 2015/2016**
5 Year	1.75%	1.90%	2.00%	2.10%
10 Year	2.45%	2.55%	2.60%	2.65%
25 year	2.90%	3.05%	3.10%	3.15%
50 Year	3.05%	3.10%	3.15%	3.20%

For budget setting and financial planning, the following rates have been assumed.

Budget Period	**Investment Returns**	**Borrowing Rates (PWLB 50 Years)**
2015/16	0.25%	5.50%
2016/17	0.75%	5.50%
2017/18	1.00%	6.00%
2018/19	2.00%	6.00%
2019/20	2.50%	6.00%

Appendix 3

Credit Risk Policy

<u>Bank Bail-In</u>

In recent times Governments bailing out failed banks has resulted in public condemnation for the use of taxpayer funds to support insolvent banks. As a result Governments and Regulators from the G20 nations have all signed up to the Bail-In proposals, an approach where retail customers of a failing bank are protected under compensation schemes (up to a threshold) and losses are covered by investors equity capital in the first instance, followed by junior debt and then senior unsecured debt and deposits. The timing of the G20 nations to introduce bank bail-in will vary between nations.

The EU has been discussing bail-in for several years, and a draft Bank Recovery and Resolution Directive was published in June 2013. This was originally planned to take effect from 2018, alongside the Basel III international rules on capital adequacy but a number of member states wanted an immediate introduction. On 12th December 2013, political agreement was reached to have the bail-in directive apply across all EU member states from 1st January 2016, two years earlier than originally planned. This would make it illegal for any EU government to bail-out (i.e. use taxpayer's funds to support a failing bank) failed/ insolvent banks.

In the UK the Independent Commission on Banking recommended introducing bail-in as a resolution tool for failing banks in 2011. Government statements since have consistently agreed with the approach of having institutional investors in banks take on the risk of failure, not the taxpayer. The Financial Services (Banking Reform) Act 2013 became law on 18th December 2013 incorporating bank bail-in.

A bail-in is likely, although not certain, to happen over the course of a weekend, with much of the preparatory work having been undertaken in advance as the bank continues to fail regulatory conditions. The announcement of a bail-in, including which creditors will be affected, will normally be made by the Bank of England on a Sunday evening before the Asian markets open. Apart from the affected creditors, the bank will open for business as normal on the Monday morning. Where a banking group comprises several UK bank companies, it is likely that all group banks will be bailed-in together. Separately capitalized subsidiaries in other countries might not be bailed-in; that will be a matter for the local regulator. Before a bail-in, the bank's ordinary shareholders will have their shares expropriated and they will therefore no longer be the bank's owners. Building societies, which are mutually owned by their customers, will be converted to banks before bail-in. Hybrid capital instruments that convert to equity in certain circumstances will also be converted. Creditors will then be bailed-in in this order:

- junior or subordinated bonds, in order of increasing seniority;
- senior unsecured bonds issued by the non-operating holding company (if any);
- senior unsecured bonds issued by the operating bank companies;
- **Uninsured deposits (money market funds, call accounts and fixed-term deposits with banks and building societies) and certificates of deposit (except interbank deposits of less than seven days original maturity); and**
- **Insured deposits that are larger than the FSCS £85,000 coverage limit.**

Note that from July 2015, the deposits of all private and voluntary sector non-financial organisations will be covered by the Financial Services Compensation Scheme. **Public sector bodies and financial companies including pension funds and Money Market Funds will remain uninsured.**

Subject to cashflow liquidity requirements, the Authority will manage bail-in risk by way investing surplus cash in instruments that are considered to be exempt from bail-in and include (and in no particular order) the Government, Corporate bonds, Registered Providers (Housing Associations) and secured bank instruments (Repos, Covered Bonds and other collaterised instruments).

These instruments are considered to have a medium to long-term investment horizon, and therefore it is likely that the Authority will hold investment instruments with financial institutions that will not be exempt from the bank bail-in process such as fixed term deposits, call accounts and money market funds. The Authority will look to limit such holdings for the purpose of managing liquidity.

Counterparty Criteria

The Authority considers, in order of priority, security, liquidity and yield when making investment decisions. Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Authority's assessment of counterparty credit risk. The intention of the strategy is to provide security of investment and minimisation of risk which will also enable diversification and thus avoidance of concentration risk.

The Authority also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. In accordance with the 2011 Treasury Management Code of Practice, the Authority will use the following key tools to assess credit risk:

- Published credit ratings of the financial institution and its sovereign rating;
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

As of 1st April 2014 the Authority is advised by Arlingclose Limited, who provides counterparty risk management services. Credit rating lists are obtained and monitored by Arlingclose, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made;
- any existing investments that can be recalled or sold at no cost will be, and
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Due to the ongoing strengthening of bank regulations it is recommended that the Authority adopts the Investment Grade scale as the minimum credit rating criteria. This will enable great flexibility when placing investments especially during periods of regulatory stress tests where the outcome can result in a downsized counterparty list as a result of the downgrading of credit ratings. Furthermore, the need to hold a diversify investment portfolio and the impact of bank bail-in regulations means that the Authority will need to adopt a more structured credit rating criteria matrix for specific instruments. **The table below details maximum monetary and investment duration limits.**

Maximum Monetary and Investment Duration Limits					
Credit Rating (Long-Term)	**Banks Unsecured**	**Banks Secured**	**Government**	**Corporates**	**Registered Providers**
UK Govt	-	-	£ Unlimited 50 years	-	-
AAA	£10m 5 years	£10m 20 years	£10m 25 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 5 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 4 years	£10m 15 years	£5m 5 years	£5m 5 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 4 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 3 years
A	£5m 12 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 2 years
A-	£5m 6 months	£10m 6 months	£5m 5 years	£5m 12 months	£5m 12 months
BBB+	£5m 100 days	£5m 100 days	£5m 2 years	£5m 6 months	£5m 6 months
BBB or BBB-	£5m next day only	£5m next day only	-	-	-
None Rated	£1m 6 months	-	-	-	-
Pooled funds	£10m per fund				

Banks Unsecured: Call accounts, term deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank [Barclays Bank Plc] or the Debt Management Office. The use of Banks unsecured instruments will be limited to aid the management of cashflow liquidity.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: The Debt Management Office, Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years. Multilateral / Supranational institutions will also be classed as Government institutions as a number of sovereign states are key shareholders.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain a high likelihood of receiving government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. **Money Market Funds** that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts to manage short-term liquidity, while **pooled funds** whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

In accordance with advice from the Authority's Treasury Management adviser, International banks will also be considered.

<u>Investment periods</u>

- **Short-term (up to 365 days)**

  At the time of writing, all short-term investments are managed in-house as a result of day-to-day cash flow management.

  For the purpose of flexibility to respond to day-to-day cash flow demands, the proposed minimum percentage of its overall investments that the Authority will hold in short-term investments is **40%**.

  Members are reminded that once a deposit has been made for a fixed period it can only be withdrawn (repaid early) by mutual consent albeit at a cost and subject to the underlying terms and conditions of the contract.

- **Long-term (one year and over)**

  Currently the Authority has no long-term investments. From 2015/2016 the Authority will invest in long-term investments. Excluding the UK Government, It is suggested that no more than £10m be placed with any one institution with duration as set out in the table above. The Authority will not have more than £40m deposited in long-term investments (the Upper Limit).

Target Rate

Forecasts of base rates can be quite diverse as illustrated by the table in ***Appendix 2***. In view of the uncertainty inherent in such predictions, it would be imprudent to set a target rate which may be difficult to achieve. In view of the foregoing, it is proposed to set a target rate of return for short-term deposits in 2015/2016 of at least **0.25%.**

This rate reflects the forecast of Bank Rate and the relationship between that rate and the rate achievable from the DMADF. If deposits are made with other counterparties as detailed in Section (a) of this Appendix, it is possible that the above rate could be exceeded.

Appendix 4 - Specified and Non-Specified Investments

Investments are categorised as “Specified” or “Non-Specified” within the investment guidance issued by the Welsh Government.

Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the “high credit quality” as determined by the Authority and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

The Authority’s credit ratings criterion is set out in **Appendix 3** and will be consulted when using the investments set out below. Credit ratings are monitored on a daily basis and the Treasury Management Adviser advise the Authority on rating changes and appropriate action to be taken.

The types of investments that will be used by the Authority and whether they are specified or non-specified are listed in the table below.

	Specified	Non-Specified
Government		
Debt Management Account Deposit Facility	✓	×
Gilts (UK Government)	✓	✓
Treasury Bills (T-Bills- UK Government)	✓	×
Bonds issued by AAA rated Multilateral Development Banks	✓	✓
Local Authority Bills	✓	×
Term deposits with other UK local authorities	✓	✓
Registered Providers (Housing Associations)		
Registered Providers (Housing Associations)	✓	✓
Corporates		
Corporate Bonds (including Floating Rate Notes and Commercial Paper)	✓	✓
Banks- Secured		
Repurchase Agreements (Repos)- Banks & Building Societies	✓	✓
Covered Bonds	✓	✓
Other Collaterised arrangements	✓	✓
Banks- Unsecured		
Term deposits with banks and building societies	✓	×
Certificates of deposit with banks and building societies	✓	×
AAA-Rated Money Market Funds	✓	×
Authority’s Banker	✓	×

Pooled Funds (Variable Net Asset Valuation)		
Other Money Market and Collective Investment Schemes	✗	✓
Pooled Funds (Property)	✗	✓

Authorisation for the in-house team

A. Short-term Investments

Due to the nature of the in-house team's duties, in that they need to respond to cash-flow fluctuations by dealing on the money market generally between 9.00am and 10.00am each day, it is impractical for each decision to be referred to the most senior management levels.

As a result, it is proposed that day-to-day decisions remain the responsibility of the Group Accountant (Financial Advice and Support) who is the *de facto* Treasury Manager. In the absence of the Group Accountant (Financial Advice and Support), the responsibility will pass to any of the appropriate line managers.

It is proposed that all Treasury Management decisions that arise from the daily cashflow will be supported by the completion of a pro-forma which will evidence compliance with the strategy.

B. Long-term Investments

It is proposed that decisions regarding long-term investments be referred to the Acting Director of Corporate Services & S151 Officer (as Chief Financial Officer) after consultation with the Acting Head of Corporate Finance and the Finance Manager for Corporate Finance.

C. General Authorisations

Whilst it is generally the intention to refer all decisions regarding long-term borrowing to the Head of Corporate Finance, there are times when to do so will risk the loss of a potentially advantageous deal, due to non-availability. This is particularly relevant to the raising of PWLB loans.

The Authority's Treasury Management Adviser continually monitors the movement of interest rates and is able to predict the changes in PWLB rates. On occasions it may be necessary to respond to advice from the Adviser to take up PWLB loans (whether as part of the current years funding requirement, or as part of a rescheduling exercise) before interest rates increase and make the necessary application to the PWLB before their cut-off time. In these circumstances, it is not always possible to have access to the Acting Head of Corporate Finance, at short notice, for approval.

As a result, it is proposed that, in the event that the Acting Director of Corporate Services & S151 Officer is unavailable, the decision be referred, in the first instance, to the Acting Head of Corporate Finance, then to Corporate Finance Manager. In the absence of all three, then the decision will be made by the Group Accountant (Financial Advice and Support) provided that the reason for the transaction is appropriately documented, falls within the approved Annual Strategy and prudential indicators, and failure to act upon the advice given would result in additional interest charges.

In all of the foregoing, it must be remembered that any action taken, based on a view of interest rates, can only be assessed on the data available at the time.

Appendix 5 Treasury Management Strategy Indicators 2015/16-2017/18

	Budget 2015-16	Budget 2016-17	Budget 2017-18
	£k	**£k**	**£k**
Authorised limit for external debt -			
Borrowing	375,328	400,192	417,495
Other long term liabilities	37,869	35,790	34,389
Total	**413,197**	**435,982**	**451,883**
Operational boundary for external debt -			
Borrowing	300,262	320,153	333,996
Other long term liabilities	37,869	35,790	34,389
Total	**338,132**	**355,944**	**368,384**
Capital Financing Requirement	356,324	365,203	369,197
Upper limits for interest rate exposure			
Principal outstanding on borrowing	300,262	320,153	333,996
Principal outstanding on investments	65,000	65,000	65,000
Net principal outstanding	**235,262**	**255,153**	**268,996**
Fixed rate limit – 100%	235,262	255,153	268,996
Variable rate limit – 30%	70,579	76,546	80,699
Upper limit for total invested for over 364 days	**40,000**	**40,000**	**40,000**

Maturity structure of fixed rate borrowing	Upper Limit	Lower Limit
Under 12 months	**35%**	**0%**
Over 12 months and within 24 months	**40%**	**0%**
Over 2 years and within 5 years	**50%**	**0%**
Over 5 years and within 10 years	**75%**	**0%**
Over 10 years	**100%**	**0%**

Gross Debt and Net Debt	2015/16	2016/17	2017/18
	£k	**£k**	**£k**
Outstanding Borrowing	300,262	320,153	333,996
Other long term liabilities	37,869	35,790	34,389
Gross Debt	**338,132**	**355,944**	**368,384**
Less investments	65,000	65,000	65,000
Net Debt	**273,132**	**290,944**	**303,384**

Gross and The CFR	2015/16	2016/17	2017/18
	£k	**£k**	**£k**
Gross Debt	338,132	355,944	368,384
CFR	356,324	365,203	369,197
CFR Breached?	No	No	No

Appendix 6 - Prudential Indicators - Capital Finance

Ratio of Financing costs to net revenue stream	**Budget 2015-16**	**Budget 2016-17**	**Budget 2017-18**
General Fund	**£k**	**£k**	**£k**
Principal repayments	8,437	8,267	8,295
Interest costs	9,418	8,065	8,477
Debt Management costs	60	49	46
Rescheduling discount	-226	-226	-226
Investment income	-163	-488	-650
Interest applied to internal balances	847	810	886
Total General Fund	**18,374**	**16,477**	**16,828**
Net revenue stream	**324,413**	**317,299**	**310,525**
Total as percentage of net revenue stream	**5.66%**	**5.19%**	**5.42%**
Housing Revenue Account	**£k**	**£k**	**£k**
Principal repayments	914	3,881	4,346
Interest costs	2,082	6,386	7,045
Rescheduling discount	-58	-58	-58
Debt Management costs	15	33	34
Total HRA	**2,953**	**10,242**	**11,368**
Net revenue stream	41,000	42,600	44,000
Total as percentage of net revenue stream	**7.20%**	**24.04%**	**25.84%**

Estimate of <u>incremental impact</u> of capital investment on Council Tax and Housing Rents	**Budget 2015-16**	**Budget 2016-17**	**Budget 2017-18**
General Fund	**£k**	**£k**	**£k**
Unsupported borrowings - principal	493	335	199
- interest	643	432	257
Loss of investment income	36	10	18
Total	**1,172**	**777**	**474**
Impact on Band D council tax	**19.67**	**13.04**	**7.95**
Housing Revenue Account	£	£	£
Loss of investment income	217	344	4
Unsupported borrowings - principal	1,509	280	242
- interest	3,771	770	726
Running costs	0	0	0
Total	**5,497**	**1,394**	**972**
Impact on average weekly rent	**0.09**	**0.38**	**0.61**

This is a notional calculation

Capital financing requirement [end of year position]	**Budget 2015-16**	**Budget 2016-17**	**Budget 2017-18**
	£k	**£k**	**£k**
Council Fund	239,890	237,928	233,214
Housing Revenue Account	116,434	127,276	135,984
Total Authority	**356,324**	**365,203**	**369,197**

Appendix 7 - Capital Expenditure and Funding

	Budget 2015-16	Budget 2016-17	Budget 2017-18
Expenditure	**£k**	**£k**	**£k**
Council Fund	14,861	11,061	9,202
Housing Revenue Account	36,290	33,100	39,100
Total	**51,151**	**44,161**	**48,302**
Funding			
Surplus/ (Deficit) Balance b/f	1,624	1,971	1,056
RCCO - Senior Pay (GF)	52		
RCCO- 12/13 Debt Management Saving (14/15 RCCO Budget)	128	128	128
Borrowings - Supported (GF)	4,985	4,985	4,985
General Capital Grant - WG	3,033	3,033	3,033
Customer First Capital Budget Underspend	122		
Borrowings - Unsupported (GF)	2,000	2,000	
General Fund Working Balances	4,845		
Capital Receipts 2014/15	43		
RCCO- (HRA)	28,700	15,900	12,100
Capital Receipts (HRA)	260	270	270
Borrowings - Unsupported (HRA)	-	9,600	19,400
Major Repairs Allowance (HRA)	7,330	7,330	7,330
Total	**53,122**	**45,217**	**48,302**
Surplus C/f	**1,971**	**1,056**	**-**

Appendix 8

MRP 2015/2016 Policy and Options

1. SUPPORTED BORROWING

OPTION 1 **Regulatory Method**	**OPTION 2** **Capital Financing Requirement Method**
Existing method of charge, no change to revenue account	Similar to Option 1, but with a change that omits a Calculation 'Adjustment A' that was caused by LGR in 1996.

Recommendation - to use Option 2 which reflects the continuation of current arrangements.

2. UNSUPPORTED BORROWING

OPTION 3 **Asset Life Method**	**OPTION 4** **Depreciation Method**
Two approaches to calculate charge to revenue: - a) Equal Instalment Method (EIM) Divides value of borrowing by estimated life of asset. Currently use 25 years. b) Annuity Method More complex with lower charge in early years, higher charge towards end of asset, when life of asset coming to end.	Similar to Option 3 but considers the revaluation of the asset and revisions to the expected asset life. Can lead to uncertainty in respect of future charges to revenue account.

Recommendation - to use Option 3 and EIM which reflects the continuation of current arrangements.

One further change, applicable to the introduction of Options 3 and 4, is a delay in the commencement of the MRP charge. Under the existing statutory approach, the charge commences in the financial year following that in which the borrowing was incurred. Under these Options, it commences when the asset, which the borrowing has been used to finance, becomes operational. There will be no ongoing effect to the revenue account as a consequence of this change.

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.