Appendix 1

Treasury Management and Investment Strategy

The County Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. This is one of the Prudential Indicators required by the Code. The CIPFA Code also requires the Council to approve a Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and TMPs were agreed by Council in February 2012. These policies remain appropriate and no changes are proposed for 2015/16.

This Treasury Management Strategy document sets out:

- The current treasury position, debt and investments;
- Prospects for interest rates;
- The borrowing strategy;
- Prudential indicators on fixed / variable borrowing and maturing debt;
- Limits to debt; and
- The investment strategy.

Analysis of Long Term Debt

The following Table A shows the County Council's fixed and variable rate debt as at 31 March 2014 and 31 December 2014 (current).

The interest rates shown do not include debt management costs or premiums/discounts on past debt rescheduling.

There has been no movement in the Council's external debt over the last financial year, as no new borrowing has been required and no further opportunities have arisen to repay debt.

Table A – Analysis of Long Term Debt

	Actual 31.03.14 £'m	Interest Rate %	Current 31.12.14 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

Schedule of Investments

The following schedule shows the County Council's fixed and variable rate investments as at 31 March 2014 and as at 31 December 2014 (current).

Table B – Schedule of Investments

		Maturing in:	Actual 31.03.14* £'m	Interest Rate %	Current 31.12.14* £'m	Interest Rate %
Fixed Rates						
	Term Deposits	< 365 days	50.00	0.93	65.00	0.76
		365 days & >	0.00		0.00	0.00
	Callable Deposits					
Variable Rate						
	Call & Notice Accounts		72.40	0.58	69.31	0.60
	Accounts linked to LIBOR Rates		0.00			
	Money Market Funds (MMFs)		0.00			
All Investments			**122.40**	**0.75**	**134.31**	**0.68**

The Council's cash balance available for investment varies during the year, with the balance building up during the first half of the financial year, and then tapering down towards the end of the financial year. It is anticipated that the cash balances at 31st March will have reduced down to around £100m.

The recent investment performance of the County Council's cash has been affected by the low interest rates introduced as part of the measures used to alleviate the global credit crunch. Interest rates have also been impacted by the introduction of new banking regulations requiring banks to hold higher levels of liquidity to act as a buffer.

The rates on offer during 2014/15 continue to be low and the returns on the County Council's cash investments are forecast to remain at the current low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult. The factors affecting interest rate movements are clearly outside the Council's control. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. The County Council retains an external advisor, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

UK interest rates have been held at their record historic low level of 0.5% since March 2009. In addition, Quantitative Easing measures to provide liquidity to markets remain in place and these may be added to by the European Central Bank in the near future. The introduction of new regulations requiring banks to hold a higher cash buffer has also had the effect of reducing the rates on offer.

A rise in the Bank of England Base Rate is thought likely during 2015, as a result of the improving economy, and the potential for stronger wage growth and higher inflation. However, most commentators are now not expecting a rise in the interest rate until the second half of 2015. Capita, who provide a treasury advisory service to Devon County Council, has also amended its forecast and has pushed back its forecast for the first rise to December 2015.

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* The figures as at 31 March 2014 and 31 December 2014 include respectively around £20.4m and £16.5m related to the Growing Places Fund (GPF). Devon County Council has agreed to be the local accountable body for the GPF, which has been established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF cash, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

The following Table C sets out interest rate forecasts over the next year. These surveys of industry practitioners reflect the view that rates will increase from the second half of 2015, but only in small increments. The longer-term rates available from the Public Works Loan Board (PWLB) are forecast to increase marginally across the entire maturity range.

Table C – Base Rate Forecasts and PWLB Rates

Base Rate	Dec (act) 2014	March 2015	June 2015	Sep 2015	Dec 2015	March 2016
Capita	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%
Capital Economics	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%
Legal & General Investment Management	0.50%	0.50%	-	-	0.75%	-
Bloomberg L.P. - Survey of Market Participants (median value)	0.50%	0.50%	-	-	1.25%	-

PWLB Rates	Dec 2014	March 2015	June 2015	Sep 2015	Dec 2015	March 2016
Capita forecast						
10 Year	2.60%	2.80%	2.80%	3.00%	3.20%	3.30%
25 Year	3.30%	3.40%	3.50%	3.70%	3.80%	4.00%
50 Year	3.30%	3.40%	3.50%	3.70%	3.80%	4.00%

When budgeting for interest payments and receipts a prudent approach has been adopted to ensure that, as far as is possible, both budgets will be achieved.

Borrowing Strategy 2015/16 – 2017/18

The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses; and
- A reduction in the average interest rate of the debt portfolio.

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Capital expenditure new starts have been limited to those that were financed from sources other than borrowing.

This strategy has worked well in a period of austerity. The Council's external borrowing level has reduced by £102m to £508m from 2008/09, whilst budgeted Capital Financing Charges reduced from £56.9m in 2011/12 to £53.6m in 2014/15.

However, as part of the process of setting the Capital Programme for 2015/16 – 2019/20, it was recognised that there are significant demands that will require additional capital expenditure. A review was therefore carried out to determine whether additional external borrowing would be required, given that current interest rates are extremely low and likely to increase. The review has identified a number of high priority schemes which require funding, but it has also been determined that these schemes can be funded from capital receipts.

There is no expectation that government funding will deviate from its current downward trajectory. The authority faces significant challenges in balancing its budget in the coming years and it is therefore difficult to imagine how significant additional borrowing could be financed. As a result the Medium Term Financial Strategy continues to assume that, over the three year period, no new long-term borrowing will be required, although this will be kept under review.

The potential to repay further debt, or refinance debt at lower rates, will continue to be closely monitored. The loans in the Council's current debt portfolio all have maturity dates beyond 2027. Under their current policy the Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB imposes premium penalties for early repayment. With current low rates of interest this would be a significant cost which would impair the benefit of repayment.

Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums. The Treasury Management team will monitor gilt yields on a daily basis, and will look to repay debt if yields rise sufficiently to cancel out the premiums, and sufficient cash is available. This may provide an opportunity in the next couple of years to repay borrowing of £19m without incurring a premium.

It is forecast that as at 31 March 2015 the Council will have cash balances of around £100m. A prudent level of balances is required to meet cashflow. In addition, the cash balances will in part be made up of earmarked reserves and will therefore be committed to meeting Council expenditure. As a result the Council's ability to repay more than a small proportion of its external debt will be limited.

If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of **1%**.

Treasury Management Prudential Indicators

These indicators seek to reduce the risks associated with fixed and variable interest rate loans and with borrowing for different loan periods.

Borrowing at fixed rates of interest for long periods can give the opportunity to lock into low rates and provide stability, but means that there is a risk of missing possible opportunities to borrow at even lower rates in the medium term.

Variable rate borrowing can be advantageous when rates are falling, but also means that there is a risk of volatility and a vulnerability to unexpected rate rises.

Borrowing for short periods or having large amounts of debt maturing (and having to be re-borrowed) in one year increases the risk of being forced to borrow when rates are high.

The Council's policy has been to borrow at fixed rates of interest when rates are considered attractive.

The proposed Prudential Indicators for 2015/16 and beyond are set out in Table D below:

Table D – Treasury Management Prudential Indicators

Prudential Indicators	Upper Limit	Lower Limit
	%	%
Limits on borrowing at fixed interest rates	100	70
Limits on borrowing at variable interest rates	30	0
Percentage of Fixed Rate Debt maturing in:		
Under 12 months	20	0
12 Months to within 24 months	25	0
24 Months to within 5 Years	30	0
5 years and within 10 Years	35	0
10 years and within 20 years	45	0
20 years and within 30 years	55	0
30 years and within 40 years	65	0
40 years and within 50 years	75	20

The limits have been set taking into account the CIPFA Code of Practice which requires that the maturity date for LOBO (Lender Option Borrower Option) loans is assumed to be the next call date, rather than the total term of the loan. This will apply to the Council's Money Market loans.

Limits to Debt

The Authorised Limit represents the level at which the council is able to undertake borrowing and in addition enter into other long term liabilities. Additional borrowing beyond this level is prohibited unless the limit is revised by the Council. Table E details the recommended Authorised Limits for 2015/16-2019/20.

Table E – Authorised Limits

	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Authorised Limits for External Debt	807,239	790,738	769,686	742,382	714,728

The Operational Boundary is based on the anticipated level of external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable. Sustained breaches would be an indication that there may be a danger of exceeding the Authorised Limits. Table F below details the recommended Operational Boundaries for 2015/16 and following years.

Table F – Operational Limits

	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Operational Limits for External Debt	782,239	765,738	744,686	717,382	689,728

The forecast opening balance for External Borrowing at 1 April 2015 is £507.85 million.
The forecast closing balance for External Borrowing at 31 March 2016 is £507.85 million.

The Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement. Table G below details the Capital Financing Requirement against the total gross debt plus other long term liabilities.

Table G – Underlying Borrowing Requirement to Gross Debt

	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Capital Financing Requirement	737,239	720,738	699,687	672,382	644,728
Gross Debt and Other Long Term Liabilities	603,838	601,133	599,172	596,091	592,911
Under / (Over) Borrowing	133,401	119,605	100,514	76,291	51,817

The debt management strategy and borrowing limits for the period 2015/16 to 2019/20 have been set to ensure that over the medium term net borrowing will only be for capital purposes.

Monitoring the Indicators

It is important to monitor performance against forward looking indicators and the requirement that borrowing should only be for capital purposes. The total level of borrowing will be monitored daily against both the operational boundary and the authorised limit. If monitoring indicates that the authorised limit will be breached, a report will be brought to the Cabinet outlining what action would be necessary to prevent borrowing exceeding the limit and the impact on the revenue budget of breaching the limit. It will be for the Cabinet to make recommendations to the County Council to raise the limit if it is felt appropriate to do so.

The indicators for capital expenditure, capital financing requirement, capital financing costs and the treasury management indicators will be monitored monthly. Any significant variations against these indicators will be reported to the Cabinet.

Investment Strategy 2015/16 – 2017/18

The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result only a small number of selected UK banks and building societies and Non-Eurozone overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.

The Treasury Management Strategy will continue to be set to ensure a prudent and secure approach.

The full County Council is required under the guidance in the CIPFA Treasury Management Code of Practice to approve an Annual Investment Strategy.

The overall aims of the Council’s strategy continue to be to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims; and
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.

A variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Council to invest, for example, in UK Government Gilts, bond funds and property funds. However, these alternative instruments would either require the Council to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down. The Council's policy therefore is not to invest in these more risky and less liquid forms of investment.

Security is achieved by the creation of an 'Approved List of Counterparties'. These are the banks, building societies, money market funds and other public bodies with whom we are prepared to deposit funds. In preparing the list, a number of criteria will be used not only to determine who is on the list, but also to set limits as to how much money can be placed with them, and how long that money can be placed for.

Banks are expected to have a high credit rating. The Council uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody's and Standard & Poor's, made available to the Council through its external Treasury Advisors. These are monitored daily.

The lowest rating published by any of the agencies is used to decide whether an institution is eligible for inclusion. This rating also determines the maximum amount which can be loaned to an individual counterparty. Additionally, any bank in which the UK Government has in excess of a 30% shareholding will be considered to be a safer investment. Non-Eurozone overseas banks that meet the criteria are included from countries with a high Sovereign rating.

The time length of all deposits with financial institutions will be managed prudently, taking account of the latest advice from the Council's external advisors.

Money Market Funds must have an 'AAA' rating, but are not currently being used.

Other public sector bodies are principally arms of Government, or other local authorities, and although not rated are deemed suitable counterparties because of their inherent low risk.

The 'Approved List of Counterparties' specifies individual institutions, and is formally reviewed at least monthly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

Table H below summarises the current 'Approved List' criteria.

Table H – Counterparty Approved List Summary

Counterparty Type		Fitch	Moody's	Standard & Poor's	Credit Limit
UK Banks with >30% UK Government ownership					
	not below	A- & F1	A3 & P-1	A- & A-1	£50 million
Other UK Banks					
	not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Building Societies					
	not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	not below	A- & F1	A3 & P-1	A- & A-1	£30 million
Non-Eurozone Overseas Banks					
	Sovereign Rating of	AAA	Aaa	AAA	
	and not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	and not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Public Bodies					
Central Government					
	– Debt Management Office				Unlimited
Local Government					
	– County Councils				£10 million
	– Metropolitan Authorities				£10 million
	– London Boroughs				£10 million
	– English Unitaries				£10 million
	– Scottish Authorities				£10 million
	– English Districts				£5 million
	– Welsh Authorities				£5 million
Fire & Police Authorities					£5 million
Money Market Funds		AAA	Aaa	AAA	Not in use

The credit ratings shown in the table for banks and building societies allow for greater sensitivity in recognising counterparty risk. Liquidity in investments is the second key factor in determining our strategy. Funds may be earmarked for specific purposes or may be general balances, and this will be a consideration in determining the period over which the investment will be made.

The counterparty limits shown in the table also apply at a banking group level. This ensures that the Council is not exposed to the risk of having maximum sums invested in multiple institutions owned by a group that encounters financial difficulties.

Credit ratings are subject to change, and a review of implied Government support for banks within its jurisdiction may lead to downgrades across the banking sector. Should such an event occur and have a significant impact on the Council's ability to implement its investment strategy then a report will be brought to Cabinet to consider any changes required to achieve the objective of our investment strategy going forwards.

The Council has a self-imposed limit of ensuring that at least 15% of deposits will be realisable within one month.

A requirement of the Prudential Code is to establish an indicator of the total principal sum invested for a period longer than 364 days, and to state the basis used in determining the amount. The purpose of this indicator is to help the Council to contain its exposure to the possibility of loss that might arise as a result of having to seek early repayment or redemption of principal sums invested.

The limit on investments over 364 days will be set at no more than 20% of the total loans outstanding at any time or £30m whichever is the lower.

For the period 2015/16 – 2017/18 it has been assumed that the interest rate earned on short-term lending will be **0.65%** p.a. throughout the three years. This will be reviewed in the light of changes to the Bank of England's base rate and any consequential improvement in the rates on offer. The inclusion of overseas counterparties provides additional flexibility, but the rates offered by some banks have reduced over the last year. The target we have set is thought to be one that is achievable.

Performance Targets

The primary targets of the Treasury Management Strategy are to minimise interest payments and maximise interest receipts over the long term whilst achieving annual budgets, without taking undue risk. Where there are comparative statistics available for individual aspects of the Strategy (e.g. the CIPFA Treasury Management Statistics) these will be used to monitor performance.