Note:

It is important to note that the Treasury Strategy Statement is adopted by the Council, based upon advice from its external Treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Council. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Council and its Treasury advisors will not accept any liability on behalf of any individual or organisation that seeks to act on the financial information contained within this Report and Statement.

Audit and Standards Committee – 10th February 2015

Report of the Chief Officer Finance and Legal Services

Treasury Management

Purpose of Report

1. The purpose of this report is:

   - to outline treasury activity in the year 2014/15 up to the end of December;
   - to seek approval of the Treasury Strategy Statement 2015/16

Background

2. Treasury Management entails the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks

3. The Council undertakes treasury management activity on its own behalf and as administering authority for the West Midlands Debt Administration Fund (WMDAF). We are responsible for administering capital funding of £755m on our own account and another £170m on behalf of other West Midlands councils in respect of the WMDAF. The treasury function is governed by the Council's Treasury Policy Statement and Treasury Management Practices.

4. Our borrowing and investment activities in the current year have been undertaken in the context of historically low interest rates. The Bank Rate has remained at 0.5% since March 2009 and is likely to remain at this rate into 2015-16 and rise gradually in the second half of 2015-16.

Treasury Activity 2014/15 - Dudley fund

5. Treasury activities in the current year have been undertaken in the context of the Treasury Strategy Statement 2014/15 approved by Audit Committee and Full Council in February 2014. In that document we anticipated that long term borrowing would be required in the next 12 months due to cashflow need.

6. Our investments up to early January have averaged £14.64 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.73% (excluding the long term investment with Salford City Council, the average return was 0.38%). All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2014/15. The performance of our investments is largely dependent on movements in short-term (up to one year) rates. The average 7-day LIBID[1] for the year to the end of December has been 0.43%. Our investment activity for 2014/15 (to date) is set out in more detail in **Appendix 1**.

7. The returns outlined above have been achieved without compromising on the security of the Council's investments. We have maintained and continue to maintain an approved investment list that sets the highest rating standards. We have an account with the Government's Debt Management Office which provides maximum security but low returns. We are only using this account where we cannot place funds with a bank that meets our strict criteria. The majority of short-term investments are in variable rate call accounts with approved counterparties, which offer a relatively good rate of return compared to fixed term deposit accounts as well as greater liquidity.

8. The average value of long-term borrowings up to the end of December 2014 was £535.2 million. The average rate of interest on these borrowings was 4.09% and they were due to mature on dates ranging from the current year to 2061.

9. The rate for a 50-year loan from the Public Works Loan Board (PWLB) has fluctuated during 2014-15 from 3.46% to 4.48% and was standing at 3.46% in early January. The Council is eligible to apply for certainty rates at 0.2% below these rates, introduced in 2012, for local authorities who provided the required information on their plans for long-term borrowing and associated capital spending. In addition the "Project Rate" which is set at 0.4% below standard rate, is available for approved single projects identified by Local Enterprise Partnerships (LEPs).

10. It has not as yet been necessary to undertake any new long-term borrowing due to favourable cash flow, but we are monitoring interest rates and cash flow closely. Medium term cash flow forecasts indicate an underlying requirement to borrow in 2015-16.

11. The Council has used short term borrowing on 22 occasions in the year to date to manage daily cash flow. The average value of the borrowing has been for £3.8m at an average rate of 0.40% for an average duration of 11 days. Daily cash balances have been mainly managed through the use of call accounts.

[1] 7-day LIBID is a measure of the average return from a 7-day investment on the London money market.

Treasury activity 2014/15 - WMDAF

12. Having consulted with our advisors at Arlingclose, we did not identify any opportunities to improve our position by restructuring of debt. The Council has used short term borrowing on 4 occasions in the year to date to manage daily cash flow for the WMADF. The average value of the borrowing has been £2.5m at an average rate of 0.44% for an average duration of 73 days. The latest estimate of interest payable by members of the WMDAF in 2014/15 is 6.4%.

Review of Investment Strategy

13. The Treasury Management Report to Audit & Standards Committee in September 2014 detailed amendments to the 2014-15 Investment Strategy which were made as a result of the Financial Services (Banking Reform) Act 2013. The legislation restricts the level of financial assistance that the UK Government can provide to a bank which gets into financial trouble, and in a serious failure there is a risk that a local authority could lose some or all of its investments with a failing institution (but this is very unlikely for a bank of very high credit quality). In order to mitigate this slightly increased risk, the amendments to the 2014-15 investment strategy essentially tightened up the Council's criteria for making investments. These amendments have been incorporated into the Treasury Strategy Statement 2015/16.

Treasury Strategy Statement 2015/16

14. The Treasury Strategy Statement covers our latest capital funding requirements, our view of interest rate movements and our strategy for borrowing and investment in the light of that view. As such, it needs to be reviewed annually. The proposed Treasury Strategy Statement for 2015/16 is attached as **Appendix 2.**

15. Our expectations for interest rates over the next twelve months, which will be subject to continuous review with our treasury advisors, are as follows (standard PWLB rates are generally about 1% above Government gilts while certainty rates are about 0.8% above gilts):

- **Short-term rates**. The Bank Rate will remain at 0.5% through 2014/15 and probably until the third quarter of 2015/16, rising very gradually thereafter
- **Long-term rates**. 20-year Government gilt rates will rise in 2015/16 from 2.95% to 3.20%
- **Very long- term rates**. 50-year Government gilt rates will rise in 2014/15 from 3.05% to 3.25%

16. The Local Government Act 2003 introduced a system of "prudential borrowing" allowing councils to set their own borrowing limits subject to criteria of prudence and affordability. These criteria are set out in more detail in the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code which specifically requires us to set a number of prudential indicators. The proposed indicators that relate to treasury management are set out in the Treasury Strategy Statement.

Local Government Association Bond Agency

17. The Local Capital Finance Company was established in 2014 by the Local Government Association (LGA) as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. The complexities associated with this source of borrowing, make it currently unsuitable for the Council anticipated borrowing needs for 2015-16 (paragraph 9.5 of Appendix 2)

Public Works Loans Board

18. The Department of Communities and Local Government has now confirmed that HM Treasury (HMT) are taking the steps to abolish the Public Works Loan Board (PWLB) in the coming months. HMT have stressed that this is purely to address the governance of the PWLB and that it will have no impact on existing loans or the government's policy on local authority borrowing. HMT has confirmed that its lending function will continue unaffected albeit under a different body so that local authorities will continue to access borrowing at rates which offer 'good value for money'.

Whilst it is not yet clear what the new governance arrangements will be, a consultation on the restructure is due out shortly.

19. In order to protect the Council's position if an individual or organisation were to act upon the views expressed in this report, we have deemed it necessary to produce a disclaimer which is shown as a note at the head of the report and **Appendix 2**.

Finance

20. Forecasts of performance against budget for treasury management activities are highly sensitive to movements in cash flow and interest rates.

Law

21. The Council has adopted CIPFA's Treasury Management in the Public Services : Code of Practice 2011 which requires the Council to approve a treasury management strategy before the start of the financial year and provide a mid-year update on treasury management activity. In addition, the Department for Communities and Local Government (DCLG) issued revised Guidance on Local Authority Investments in 2010 that required the Council to approve an investment strategy before the start of each financial year. This report fulfils the legal obligation under the Local Government 2003 to have regard to both the CIPFA code and the DCLG guidance.

Equality Impact

22. The treasury management activities considered in this report have no direct impact on issues of equality.

Recommendation

23. That the Committee:

- notes the treasury activities in 2014/15 outlined in this report;
- approves the Treasury Strategy 2015/16 attached as Appendix 2;
- authorises the Chief Officer Finance and Legal Services to effect such borrowings, repayments and investments as are appropriate and consistent with the approved Treasury Strategy and relevant guidance;
- refers all of the above for approval by full Council at its meeting on 23rd February

…………………………………………..
Iain Newman
Chief Officer Finance and Legal Services

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List of Background Papers

- Treasury Policy Statement, Treasury Management Practices and Schedules to the Treasury Management Practices.
- The Local Government Act 2003
- The Prudential Code for Capital Finance in Local Authorities (CIPFA)
- Guidance on Local Government Investments Issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003
- Code of Practice for Treasury Management in the Public Services (CIPFA)

Appendix 1

Investment Activity 2014/15 to 5th January 2015

Counterparty name	**Number of investments**	**Average value £ million**	**Average rate %**	**Average duration (days)**
Barclays Treasury Direct	5	1.13	0.33	16
Barclays	1	0.39	0.28	22
Debt Management Office	16	1.52	0.25	8
Nationwide Building Society	1	0.51	0.42	31
Bank of Scotland Call Account	NA	4.08	0.40	Call
Santander Call Account	NA	4.19	0.40	Call
HSBC Call Account	NA	2.31	0.32	Call
Salford City Council *	1	0.5	11.25	Matures in 2020

The table above includes investments that commenced during 2013/14 and were due to mature in the current financial year.

* This is a fixed term deposit that was made in 1985 and is due to mature in 2020.

Appendix 2

Note:
It is important to note that the Treasury Strategy Statement is adopted by the Council, based on advice from its external Treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Council. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Council and its Treasury advisors will not accept any liability on behalf of any individual or organisation that seeks to act on the financial information contained within this Report and Statement.

DUDLEY METROPOLITAN BOROUGH COUNCIL
TREASURY STRATEGY STATEMENT 2015/16

1.0 Introduction

1.1 This Treasury Strategy Statement details the expected activities of the treasury function in the financial year 2015/16. The suggested strategy is based upon officers' views of interest rates as advised by external advisors, supplemented with leading market forecasts. It should be noted that the use of expert external advisors does not remove the responsibility of Members and officers for treasury management functions and that those functions cannot be delegated to any outside organisation. The strategy covers:

- the current portfolio position
- prudential and treasury indicators
- prospects for interest rates
- temporary investment strategy
- requirements and strategy for long-term borrowing
- debt rescheduling and premature repayment opportunities
- treasury implications of HRA Self Financing

2.0 Current Portfolio Position

2.1 The Council's estimated debt position as at 1st April 2015 is as follows:

	£m
Long-term debt:	
- PWLB fixed rate	534.0
- PWLB variable rate	13.0
- Market fixed rate	6.8
- Market LOBO2	10.0
Short-term debt	11.0
Total debt	**574.8**

2.2 The average rate of interest on the above debt is expected to be 3.97%.

2 Lenders Option Borrowers Option (LOBO). This loan was at a fixed rate of 4.6% until February 2009 after which the rate may be varied at the lender's option. If the lender exercises this option to vary the rate then we, as the borrower, have the option to repay the loan.

2.3 The average level of investments held by the Council during 2014/15 to early January 2015 was £14.64m. Cash flow monitoring indicates that long term borrowing may be required in the next 12 months.

2.4 The Council also administers the debt of the former West Midlands County Council on behalf of the West Midlands districts. The estimated debt position at 1st April 2015 is as follows:

	£m
Long-term debt:	
- PWLB fixed rate	162.6
- Market fixed rate	6.8
- Market LOBO3	10.0
Short-term debt	0.0
Total debt	**179.3**

2.5 The average rate of interest charged to the West Midlands fund is expected to be 6.4%.

3.0 Prudential & Treasury Indicators

3.1 Under the Local Government Act 2003 and the Prudential Code for Capital Finance in Local Authorities, local authority capital spending and its borrowing to fund that spending is limited by what is affordable, prudent and sustainable. The Prudential Code sets out a number of indicators that enable the authority to assess affordability and prudence. The following indicators are relevant for the purposes of setting an integrated treasury management strategy.

3.2 Treasury Indicators in the Prudential Code

3.3 The Prudential Code requires that the total external debt does not exceed the Authorised Limit for external debt and only exceeds the Operational Boundary for external debt temporarily on occasions due to variation in cash flow.

These external debt indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. It has been calculated to take account of the Council's capital expenditure and financing plans and allowing for the possibility of unusual cash movements. The operational boundary for external debt has also been calculated with regard to the Council's capital expenditure and financing plans allowing for the most likely, prudent, but not worst case scenario for cash flow. Temporary breaches of the operational boundary, due to variations in cash flow, will not be regarded as significant. Actual external debt represents the closing balance for borrowing and other long-term liabilities.

	2013/14	2014/15 Revised	2015/16 Revised	2016/17 Revised	2017/18
	£m	£m	£m	£m	£m
Authorised limit for external debt:					
Borrowing	n/a	904	893	882	860
Other long term liabilities	n/a	37	43	36	30
Total	n/a	**941**	**936**	**918**	**890**
Operational boundary:					
Borrowing	n/a	775	796	800	801
other long term liabilities	n/a	37	43	36	30
Total	n/a	**812**	**839**	**836**	**831**
Actual External Debt:					
Borrowing	735.9	n/a	n/a	n/a	n/a
Other long term liabilities	32.1	n/a	n/a	n/a	n/a
Total	**768.0**	**n/a**	**n/a**	**n/a**	**n/a**

Gross Debt and the Capital Financing Requirement:

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

The Council has met this requirement in 2014/15, and expects to do so in future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3.4 Treasury Indicators in the Treasury Management Code

CIPFA Code of Practice for Treasury Management in the Public Services

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

Interest rate exposures

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for fixed interest reflects the fact that it is possible to construct a prudent treasury strategy on the basis of using only fixed rate debt and investments, so long as the maturity dates of these debts and investments are reasonably spread. The same does not apply to variable rates where a 100% exposure could lead to significant year on year fluctuations in the cost of debt. The upper limit for variable rate exposure allows for the use of variable rate debt to offset our exposure to changes in short-term rates on our portfolio of investments. This limit reduces over time as our strategy is to gradually reduce our level of investments.

	2014/15	**2015/16**	**2016/17**	**2017/18**
Upper limit for fixed interest rate exposure	100	100	100	100
Upper limit for variable rate exposure	10	10	10	10

Maturity structure of borrowing and investments

The maturity structure of fixed rate borrowing is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

	Upper Limit %	**Lower Limit %**
Under 12 months	10	0
12 months and within 24 months	10	0
24 months and within 5 years	15	0
5 years and within 10 years	25	0
10 years and above	100	40

Upper Limit for total principal sums invested over 364 days

The purpose of the limits for principal sums invested for periods longer than 364 days is to contain the Council's exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested. On the basis of prudent treasury management the proposed upper limit on principal maturing in any one year for sums invested for over 364 days is £10m.

4.0 Economic Background

4.1 There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that the growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansions of Gross Domestic Product (GDP). However, inflationary pressure is benign and is likely to remain low in the short-term, partly due to recent large falls in the oil price. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak.

4.2 The Monetary Policy Committee's (MPC) focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings between August and December 2014, the minutes of the January 2015 meeting showed unanimity in maintaining the bank rate at 0.5% as there was sufficient risk that low inflation could become entrenched and the MPC became more concerned about the economic outlook.

5.0 Credit outlook

5.1 The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The Bank Recovery and Resolution Directive promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast Deposit Guarantee Schemes Directive includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

5.2 The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, the credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Authority.

6.0 Prospects for Interest Rates:

6.1 The Authority's treasury management advisor Arlingclose forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year. Arlingclose projects gilt yields on an upward path in the medium term (see below).

6.2 Our expectations of interest rates over the next twelve months, which will be subject to continuous review with our treasury advisors, are as follows (standard PWLB rates are generally about 1% above government gilts, whilst certainty rates are about 0.8% above gilts) :

- **Short-term rates**. The Bank Rate will remain at 0.5% through 2014/15 and probably until the third quarter of 2015/16, rising very gradually thereafter
- **Long-term rates**. 20-year Government gilt rates will rise in 2015/16 from 2.95% to 3.20%
- **Very long- term rates**. 50-year Government gilt rates will rise in 2014/15 from 3.05% to 3.25%

6.3 Our overall strategy will be based on the projections above. However, we will maintain flexibility to take account of unexpected variations from our forecast.

7.0 Annual Investment Strategy

7.1 Our investment activities are subject to government guidance issued under Section 15(1) (a) of the Local Government Act 2003. This section of the Treasury Strategy Statement constitutes an "Annual Investment Strategy" produced in accordance with the guidance.

7.2 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. We have a policy of keeping cash balances at minimum levels by maximising the use of internal borrowing to finance capital expenditure. In the current financial year, the Authority's cash balance has ranged between a high of £35m in May to a deficit of £26m in December. This is substantially lower than last year when the balance ranged from a high of £84m to a low of zero in the same period. This is partly as a result of electing to pay employer's superannuation contributions in single annual instalment in exchange for a reduction in those contributions. Based on seasonal trends, the level of investments (and therefore the risk) is likely to be significantly lower for the rest of this financial year and into next year.

7.3 In accordance with Investment Guidance issued by the Department of Communities and Local Government (DCLG) and best practice the Council's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yields earned on investments is important but are secondary considerations.

7.4 *Strategy for "specified investments*"

7.4.1 The Council will make use of specified investments (as defined within the terms of the government guidance). These are investments that satisfy the following conditions:

a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
b) The Council may require that the investment be repaid or redeemed within 12 months of the date on which the investment was made.
c) The making of the investment is not defined as capital expenditure by legislation
d) The investment satisfies either of the following conditions:

I. The investment is made with the UK government, a local authority, a parish council or a community council. or
II. The investment is made with a body or in an investment scheme of high credit quality

7.4.2 For the purpose of this strategy a body or investment scheme is deemed to be of high credit quality if it has minimum short-term ratings of F1 (Fitch), P1 (Moody's), and A1 (Standard and Poors).

7.4.3 In order to reduce risk of loss from a bank default, the Council has also applied the following criteria for investments :

- Investments of a maximum duration of 3 months are permitted with UK institutions which have the highest short term credit rating from all three main credit rating agencies i.e. F1+ (Fitch), A1+ (Standard & Poors), P1 (Moody's)

- Investments of a maximum duration of 1 month are permitted with UK institutions with a minimum short term credit rating of F1 (Fitch), A1 (Standard & Poors), and P1 (Moody's).

7.4.4 Since the financial crisis of 2008, the Council has not allowed investments in non-UK institutions. The existing strategy is based on the implicit assumption that the UK Government would support a failing UK bank. This factor is less relevant in light of the Financial Services (Banking Reform) Act 2013 and proposed regulations. That said, current cash flow predictions do not suggest that there is any compelling need to widen the investment strategy to non-UK institutions and so there is no proposal to change.

7.4.5 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria

7.4.6 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 for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

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

7.4.8 If conditions in the financial markets worsen during 2015-16 or other factors indicate that increased security of Council funds is required, the Chief Officer Finance and Legal Services may impose tighter restrictions on the type of investments and institutions used by the Council, than those detailed in this strategy.

7.4.9 The Council banks with HSBC. At the current time, it does meet the minimum credit criteria and has the highest credit rating for a UK bank. Even if the credit rating falls below the Council's minimum criteria HSBC will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

7.5 *Strategy for "non-specified investments"*

7.5.1 Non-specified investments are those that do not meet the criteria for a specified investment detailed in 7.4.1 above. The Council does not intend to make any investments denominated in foreign currencies, or any that are defined as capital expenditure by legislation such as company shares. Neither is there an intention to make new long term investments, especially in the light of maximising the length of any investment to 3 months irrespective of its credit quality. Therefore the Council will not place its funds with non-specified investments.

7.6 Liquidity of investments

7.6.1 In determining the maximum period for which investments may be held, we will have regard to our most recent cash-flow forecast. We will not enter into an investment where our cash-flow forecast indicates that, as a result of that investment, we would be forced to borrow money at a later date that we would not otherwise have had to borrow.

7.6.2 The criteria for investments detailed in 7.4.3 will ensure that investments are not made for periods exceeding 3 months thereby ensuring that the Council's cash is readily available for day to day operations, as well as reducing the risk of capital loss.

7.7 Limit on investments with a single institution

7.7.1 In order to limit the Council's exposure to a single default, investments with a single institution or group of banks **should not exceed £5million** at any time. This limit also applies to other local authorities but not to the Debt Management Office which has no upper limit as investments with the UK Government are deemed to be at the lowest level of risk.

8.0 Policy on the Use of Financial Derivatives

8.1 A financial derivative is a contract whose value is based on, or "derived" from, an underlying financial instrument such as a loan. Local authorities have previously been able to make use of financial derivatives embedded into loans and investments, both to reduce interest rate risk (e.g. forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

8.2 The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

8.3 The Council does not intend to use standalone financial derivatives (such as swaps, forwards, futures and options). Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but no change in strategy will be made without full Council approval.

9.0 Requirements and Strategy for Long-Term Borrowing

9.1 The primary factor in determining whether we undertake new long-term borrowing will be cash flow need. We will seek to minimise the time between borrowing and anticipated cash flow need, subject to the need to maintain day to day liquidity.

9.2 Our interest rate expectations (outlined in 6.2) provide a variety of options:

- that short-term variable rates will be good value compared to long-term rates, and are likely to remain so for potentially at least the next couple of years. Best value will therefore be achieved by borrowing short term at variable rates in order to minimise borrowing costs in the short term.

- that the risks intrinsic in the shorter term variable rates are such, when compared to historically relatively low long term fixed funding, which may be achievable in 2015/16, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding at a marginally higher rate than short term rates.

9.3 Against this background caution will be adopted with the 2015/16 treasury operations. The Chief Officer Finance and Legal Services will monitor the interest rate market and adopt a pragmatic approach to changing circumstances.

Sensitivity of the forecast - The main sensitivities of the forecast are likely to be the two scenarios below. In conjunction with the treasury advisers, we will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap

- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to growth rates remaining low or weakening, then long term borrowings will be postponed

9.4 With respect to the West Midlands Debt, variances due to timing differences b etween the maturity profile of the debt and repayments from authorities can be managed by short term borrowing in 2015-16. As a result, we do not anticipate that further long-term borrowing will be needed during 2015/16. We shall take out long term borrowing on West Midlands debt when it is economically advantageous to do so.

Local Government Association Bond Agency

9.5 The Local Capital Finance Company was established in 2014 by the Local Government Association (LGA) as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons; borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the authority and used to bolster the Agency’s capital strength instead.

9.6 Due to the nature of the Council’s anticipated borrowing requirements, it does not intend to borrow from the LGA Bond Agency in 2015/16.

10.0 Debt Rescheduling and Premature Repayment Opportunities

10.1 We may consider rescheduling or premature repayment with the following aims:

- the generation of cash savings at minimum risk;
- in order to help fulfil the strategy outlined in 8 above;
- in order to enhance the balance of the long-term portfolio (by amending the maturity profile and/or the balance of volatility).

10.2 Any rescheduling or premature repayment will be reported to an appropriate committee at the meeting following its implementation.

11.0 HRA Self Financing

11.1 On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.

11.2 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. An average of this notional balance will be calculated annually and interest transferred between the General Fund and HRA at an internally determined rate of interest, adjusted for risk.

12.0 Training

12.1 CIPFA's Code of Practice requires the Chief Officer Finance and Legal Services to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Relevant training is provided by Arlingclose to the members of the Audit Committee.

12.2 The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Chief Officer Finance and Legal Services will recommend and implement the necessary arrangements.

13.0 Treasury Management Advisors

13.1 The Council uses Arlingclose Ltd as its external treasury management advisers. 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.

13.2 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 maintains the quality of the service with its advisors by holding regular meetings and tendering periodically for the provision of treasury management advice

13.3 The Council receives the following services from Arlingclose :

a. Credit advice
b. Investment advice
c. Technical advice
d. Economic & interest rate forecasts
e. Workshops and training events for officers and members