Report To:	**EXECUTIVE CABINET AND OVERVIEW (AUDIT) PANEL**
Date:	8 February 2017
Executive Member / Reporting Officer:	Cllr Jim Fitzpatrick – First Deputy (Performance and Finance) Ian Duncan – Assistant Executive Director (Finance)
Subject:	**TREASURY MANAGEMENT STRATEGY 2017/18**
Report Summary:	The report sets out the Council's borrowing strategy for 2017/18 and the Annual Investment Strategy.
Recommendations:	1. That the report be noted and the proposed borrowing strategy be supported. 2. That the Annual Investment Strategy be recommended for approval by the full Council, including the changes set out in section 14 of this report
Links to Community Strategy:	The Treasury Management function of the Council underpins the ability to finance the Council's priorities.
Policy Implications:	In line with Council Policies.
Financial Implications: **(Authorised by the Section 151 Officer)**	The achievement of savings on the cost of financing the Council's debt through repayment, conversion and rescheduling, together with interest earned by investing short term cash surpluses, is a crucial part of the Council's medium term financial strategy. This has to be carefully balanced against the level of risk incurred. The financial implications are determined by: • The value and timing of any borrowing undertaken (if any) • The amount of cash available for investment and the return achieved on this investment The Council actively reviews the opportunities to maximise the return on its investments. It is possible that improved returns may be obtained from asset backed securities, and a change to the Treasury Management Strategy is recommended in order to allow investment in such instruments.
Legal Implications: **(Authorised by the Borough Solicitor)**	The report complies with the Council's financial regulation 17.3. The Council is required by statute to set and maintain a balanced budget, careful management of the finances allows the Council to achieve this and this report provides a means for Members to carefully monitor the situation.
Risk Management:	Failure to properly manage and monitor the Council's loans and investments could lead to service failure and financial loss.
Access to Information:	The background papers relating to this report can be inspected by contacting Beverley Stephens, Finance Business Partner, by: phone: 0161 342 3887 e-mail: beverley.stephens@tameside.gov.uk

1. INTRODUCTION

1.1 The Treasury Management service is an important part of the overall financial management of the Council's affairs. At 31 March 2016 the Council had £156m of investments which need to be safeguarded, and £120m of debt. The Council is also the lead authority responsible for the administration of the debt of the former Greater Manchester County Council on behalf of all ten Greater Manchester Metropolitan Authorities. As at 31 March 2016, this was a further £110m of debt. The significant size of these amounts requires careful management to ensure that the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

1.2 Under the Local Government Act 2003, the Department for Communities and Local Government issued in March 2010 revised "Guidance on Local Government Investments". The 2003 Act requires an authority "to have regard" to this guidance. Part of this guidance is that "A local authority shall, before the start of each financial year, draw up an Annual Investment Strategy for the following financial year, which may vary at any time. The strategy and any variations are to be approved by the full Council and are to be made available to the public." This strategy is set out in **Appendix A**.

1.3 A revised edition of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice was produced in November 2011. The guidance arising from this Code has been incorporated within this report.

1.4 This report also sets out the estimated borrowing requirement for both Tameside MBC and the Greater Manchester Metropolitan Debt Administration Fund (GMMDAF), together with the strategy to be employed in managing the debt position.

1.5 The Local Government Act 2003 is the major legislation governing borrowing and investments by local authorities. Under the Act a Local Authority may borrow money:

(a) For any purpose relevant to its functions under any enactment; or

(b) For the purposes of the prudent management of its financial affairs.

1.6 However, an authority has a duty to ensure that its borrowing is affordable, and must set its own limits on how much it may borrow. The method of doing this is set out in the Prudential Code for Capital Finance in Local Authorities. This is covered in the Capital Strategy and Programme, and the limits imposed by the Council will be adhered to within the Treasury strategy.

1.7 The limits set by the Council are based on the possibility of borrowing in advance of our needs, should interest rates be such that it is advantageous to do so. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash balances have been used. This strategy is prudent as investment returns are low and interest rates are comparatively high, thus creating a high cost of carry for any borrowing taken up. The Council, along with its advisors, Capita, will closely monitor rates and take up borrowing at the most advantageous time possible.

1.8 Against this background and the continuing risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach in changing circumstances. Borrowing will be undertaken on an assessment of the situation at the time.

2. CODE OF PRACTICE

2.1 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2011). The Council has adopted the revised Code of Practice on Treasury Management.

2.2 Part of this code is for the Council to set out Treasury Management Practices (TMPs). These are in place and are being adhered to.

3. NEED TO BORROW

3.1 The Council's long term borrowing requirement in any year depends on the following factors:-

(a) Existing loans which are due to mature during the year. These will include external loans, and any reduction of internal resources that are temporarily being used to finance capital expenditure.

(b) The amount of capital expenditure that the Council has determined should be financed by borrowing. Under the Prudential Code on Borrowing the Council may determine its own levels of borrowing and is set by the Council as part of the main budget process. The Council is able to borrow in advance of its requirements, when it is considered beneficial to do so.

(c) The amount of outstanding debt required to be repaid during the year, including the "Minimum Revenue Provision" (MRP) and additional voluntary MRP to repay prudential borrowing.

3.2 The Council has some flexibility to borrow funds this year for use in future years. The Section 151 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints.

Any borrowing in advance undertaken will be made within the constraints that:

- It will be limited to no more than 75% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Borrowing would not be undertaken more than 24 months in advance of need.

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

The Council may also borrow on a short term basis to finance temporary shortfalls in cash flow.

3.3 In addition to this, the Council will fund capital expenditure by using internal cash balances. Although we do not borrow to meet this expenditure, it has the effect of reducing our investments, and therefore changing the net interest payable.

4. TYPES AND DURATION OF LOANS

4.1 There are various types of loan available:-

(a) Short term fixed.
These are loans of less than one year duration where the interest rate is agreed at the start of the loan and remains the same until the loan matures. The duration may last from 1 day to 364 days.

(b) Short term variable.
Less than one year, but the interest rate may change during the life of the loan.

(c) Long term fixed
As (a), but greater than one year (may be up to 50 years).

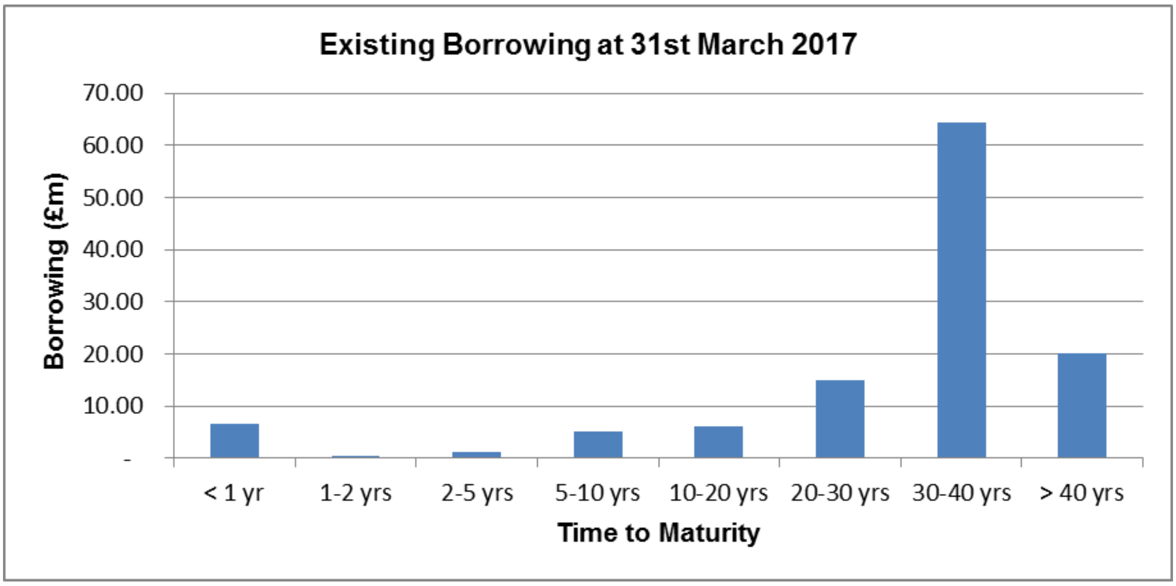
(d) Long term variable
As (b), but life normally between 1 and 10 years.

(e) LOBOs (Lender's Option Borrower's Option)
These are bank loans where the interest rate is fixed for a number of years (often with an automatic increase built in). At the end of this fixed rate period, the bank may (at pre set anniversaries) take up an option to increase the rate. The borrower (Tameside) then has the option to repay the loan if we do not want to pay the higher interest rate. We can only repay the loan prior to the maturity date without penalty if the lender has taken up their option.

4.2 Interest rates are continually changing and are determined by economic and market conditions. Short term variable rates tend to reflect the current Bank of England Minimum Lending Rate (Bank Rate), but can vary (sometimes by more than 1%) due to market conditions. The on-going uncertainty in the financial markets has caused considerable volatility.

4.3 Long term fixed rates are based on Government Gilts (Bonds issued by the Government which pay a fixed rate of interest) and reflect the future expectations of base rates, inflation and risks within the general economy. They may be markedly different from short term rates, and they may also be volatile. At present interest rates on longer term loans are higher than short term rates due to the relatively low Base Rate, implemented by the Monetary Policy Committee of the Bank of England. The programme of "quantitative easing" undertaken by the Bank of England and the "safe haven" status of the UK continues to restrict gilt interest rates.

4.4 Tameside's loan portfolio as at 31st March 2017 is estimated to contain £78m long term fixed loans from the PWLB, £10m long term fixed bank loans and £30m of LOBOs. The following graph outlines the maturity profile:



5. SOURCES OF BORROWING

5.1 Loans to fund the borrowing requirement may be raised from any source approved by the Local Government Act 2003.

The main sources currently available to Tameside are:-

a. The Public Works Loan Board (PWLB) (£78m at 31st March 2017)
b. European Investment Bank (EIB) (no current borrowing)
c. Banks, Building Societies and other financial institutions (£40m at 31st March 2017)
d. Internal cash funds and balances.

Of these, by far the greatest proportion is normally obtained from the PWLB.

5.2 The PWLB is, in effect, the Government, and loans raised from this source are generally the cheapest available for their type and duration. Although loans from the PWLB may be obtained at a variable rate of interest, they are normally borrowed at fixed rates.

5.3 In November 2016 the Government confirmed its plans to abolish the PWLB and transfer its functions for lending to local authorities to the Treasury, with operational responsibility delegated to the Debt Management Office (DMO). The proposals only affect the governance arrangements and do not change any of the policy or operational aspects of lending to local authorities. The Government is planning to lay a draft Order before Parliament to implement these changes, but there is no clear timescale on when the change will be implemented at this stage. For the purposes of this report, the term “PWLB” will continue to be used to refer to Government lending.

5.4 Whilst the Public Works Loan Board, part of HM Treasury, is the primary lender to local authorities, the European Investment Bank (EIB) will also provide support for funding infrastructure projects throughout the EU. This source of funding is priced in a similar way to the PWLB, but requires applications for specific projects. These projects must further EU policy requirements and be financially, technically and environmentally viable. They are particularly aimed at regional development issues. The Association of Greater Manchester Authorities (AGMA) has negotiated a borrowing facility with the EIB, which could be available to the council in due course if appropriate.

5.5 Borrowing for fixed periods means that the average rate payable is not subject to large year on year volatility which could occur if rates were linked to the base rate of interest.

5.6 Internal funds, such as the Insurance Fund, are paid interest in line with short term rates.

5.7 Traditionally the strategy employed by Tameside and most other Local Authorities is to borrow long term at fixed rates of interest.

5.8 Where appropriate the Council may undertake borrowing for external organisations for policy reasons, and this will be on the basis that the revenue costs are fully reimbursed.

6. RESCHEDULING

6.1 Rescheduling involves the early repayment and re-borrowing of longer term PWLB loans, or converting fixed rate loans to variable and vice versa. This can involve paying a premium or receiving a discount, but is intended to reduce the overall interest burden, since the replacement loan (or reduction of investment) is normally borrowed at a lower interest rate.

6.2 The use of rescheduling is a valuable tool for the Council, but its success depends on the frequent movement of interest rates, and therefore it cannot be estimated for. It will continue to be used when suitable opportunities arise, in consultation with our treasury management advisors, although such opportunities may not occur.

6.3 The changes made by the PWLB in 2010 to introduce separate rates for the premature repayment of debt and the increase in the cost of new PWLB borrowing by approximately 1%, has significantly reduced the ability to re-schedule debt. No re-scheduling has been undertaken by the Council since these changes occurred.

6.4 However, the PWLB has continued a scheme to allow a 0.20% reduction on the published borrowing rates, known as the “certainty rate”, for Councils that provide indicative borrowing requirements for the next 3 years. The Council has provided this information and has therefore protected its eligibility for the certainty rate. This does not however commit the Council to a particular course of action.

6.5 With the current yield curve, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Section 151 Officer and our treasury management advisors will monitor prevailing rates for any opportunities during the year.

6.6 Although a pro-active approach is taken to identify opportunities to re-schedule debt, no such an opportunities have arisen so far in 2016/17.

6.7 Consideration will also be given to identify if there is any potential for making savings by utilising cash balances to repay debt prematurely, as short term rates on investments are likely to be lower than rates paid on current debt.

7. CURRENT POSITION – 2016/17

7.1 The original estimate of interest payable for the current year was £8.881m. Of this £8.778m will be paid externally and the remainder will be paid to various Council funds such as the Insurance Fund. It is anticipated that the outturn position for the year will be in line with this budget.

8. TAMESIDE MBC'S ESTIMATED POSITION AT 31 MARCH 2017

8.1 Following transactions and activity expected prior to the financial year end it is anticipated that at the end of the current financial year, the Council's net borrowing position will be:-

	£m
PWLB	78.477
Market Loans (incl. LOBOs)	40.000
Less Sports Trust debt*[1]	-2.259
Less Airport Terminal 2 debt*[2]	-1.622
Net Tameside Long term loans	114.596
Trust Funds, Contractor Deposits etc	0.145
Total external borrowing	114.741
Internal cash balances	185.932
Less Investments	-160.205
Net Creditor position	0.292
Net Debt outstanding	140.760

*[1]*see paragraph 8.4*
*[2]*see paragraph 8.3*

8.2 The estimated position assumes the Council will not take up any borrowing during 2016/17, to meet the forecast outstanding borrowing requirement as at 31 March 2017 (£73.086m) and no advanced borrowing for 2017/18 or future years. By postponing borrowing and utilising cash balances, the Council reduces counterparty risk and the financial impact of the current low level of investment returns.

8.3 The PWLB figure includes an outstanding amount of £1.622m, of an original amount of £10.02m taken over from Manchester Airport on 31st March 1994 to facilitate Terminal 2. The Airport fully reimbursed the Council with both the principal and interest repayments in respect of these loans until 9 February 2010, when it re-negotiated the terms of this agreement with the 10 Greater Manchester Districts. The Airport now pays the Council an annual fixed interest of 12% on the outstanding balance at 9 February 2010 (£7.295m) and agreed to repay the loan by 2055.

8.4 Prudential borrowing of £4.280m was taken up on 25 July 2008 from the PWLB on behalf of the Tameside Sports Trust, to enable facility improvements. The costs related to this borrowing are met by reducing the annual Council's grant paid to the Sports Trust by an equal amount. The outstanding amount at 31 March 2016 will be £2.259m.

8.5 The total amount of the Council's gross external debt (excluding Airport and Sports Trust debt) is £140.760m.

9. 2017/18 BORROWING REQUIREMENT

9.1 As stated earlier the authorised limits for debt under the Prudential Code allow for borrowing in advance. This will only be done if interest rates for longer term loans are advantageous to the Council and the counterparty risk to the Council on investments is acceptable, or such borrowing will afford an opportunity for debt rescheduling.

9.2 During 2017/18 it is estimated that the following requirement will be needed in respect of the general fund:-

	£m
Capital expenditure (financed by loan)	12.740
Loans maturing	6.466
	19.206
Less Debt repayments	-4.071
Total potential borrowing requirement	15.135

9.3 Therefore the additional outstanding capital borrowing need of the Council will be £15.135m (capital expenditure less debt repayments) during 2017/18.

9.4 The budget for 2017/18 shows that loans and investments outstanding during the year will generate estimated net interest charges of £4.349m, of this £4.175m will be paid externally and the remainder will be paid to various Council funds. Under current Local Government accountancy rules no interest is payable in respect of the Councils capital receipts and revenue balances. This has no net effect on the overall finances of the Council.

9.5 During 2018/19 it is estimated that the following requirement will be needed in respect of the general fund:-

	£m
Capital expenditure (financed by loan)	6.524
Loans maturing	0.320
	6.844
Less Debt repayments	-4.390
Total potential borrowing requirement	2.454

9.6 Therefore it is estimated that there will be an additional borrowing requirement during 2017/18 of £2.454m

10. GREATER MANCHESTER METROPOLITAN DEBT ADMINISTRATION FUND (GMMDAF) REQUIREMENT

10.1 Unlike Tameside MBC the GMMDAF incurs no capital expenditure, and therefore the total debt outstanding reduces annually by the amount of debt repaid by the constituent authorities. However, loans are raised to replace those maturing during the year and also for cash-flow purposes.

10.2 At 31 March 2017 it is expected that the fund will have the following outstanding debt:

	£m
PWLB	67.962
Transferred Debt	0.197
Temporary Borrowing	24.098
Creditors	1.178
Total Debt	93.435

10.3 The fund's borrowing requirement for 2017/18 is estimated to be:

Long term debt maturing	**£m**
PWLB	3.000
Other	0.041
	3.041

Less principal repayments	-16.996
Surplus	-13.925

10.4 During 2017/18 it is estimated that the total interest payments will be £5.622m at an average interest rate of 4.90%. This compares with 5.73% in 2014/15, 5.30% in 2015/16 and a revised estimate of 5.09% in 2016/17.

10.5 Further loans may be taken up for either re-scheduling or borrowing early for future years, if prevailing rates are considered attractive.

10.6 During 2009/10, Manchester Airport re-negotiated the terms of its loan arrangement with the 10 Greater Manchester Districts, as a result of this agreement the 10 Districts have taken responsibility to service the former Manchester Airport share of the GMMDAF. The Airport has agreed to pay the Districts an annual fixed interest of 12% on the outstanding balance at 9 February 2010, and repay the loan in 2055. Previously, this element of GMMDAF debt was serviced by the Airport itself.

11. BORROWING STRATEGY

11.1 The Council has the following anticipated borrowing requirement:-

	Annual Requirement (£m)	**Total Required (£m)**	**Estimated Annual Cost* (£m)**
Prior years		68.931	1.551
Estimate 2016/17	4.155	73.086	3.195
Estimate 2017/18	15.135	88.221	5.269
Estimate 2018/19	2.454	90.675	7.581

*calculated as annual interest charge on total requirement if borrowing taken up at estimated 50 year PWLB rate, less current interest rate on investments. This would only be incurred if all borrowing was taken up.

The GMMDAF has a borrowing requirement of £15.922m for 2016/17 and an estimated surplus of £13.925m for 2017/18. This surplus will be offset against the borrowing requirement.

11.2 As shown above, the Council is currently maintaining an under-borrowed position estimated to be £72.621m at 31st March 2017. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash has been used. This strategy is prudent as investment returns are low and counterparty risk is high. The Council continues to have a high level of investments, and it is expected that these will continue during the next financial year. The Council will seek to maintain levels of external debt as low as possible, consistent with a consideration of wider risks and benefits.

11.3 The uncertainty over future interest rates and concerns over counterparty credit worthiness increases the risks associated with treasury activity. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach in changing circumstances. PWLB loans may be borrowed in order to reschedule debt or meet the outstanding borrowing need as is felt to be appropriate. The possibility of deferring borrowing until later years to reduce our level of investments and associated counterparty risk will be considered.

11.4 As a result the Council will take a cautious approach to its borrowing strategy and all opportunities explored in conjunction with our treasury management advisors. Borrowing decisions will be based on the circumstances prevailing at the time.

11.5 Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. The Section 151 Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks outlined above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

11.6 The borrowing rules for the PWLB mean that we are able to borrow our full requirement from them. However, if interest rates in respect of LOBOs are sufficiently attractive, these may be used for Tameside. The length of loans required for LOBOs mean they are unsuitable for the GMMDAF.

11.7 It is likely that the Municipal Bond Agency will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

12. INTEREST RATES

12.1 The borrowing and investment strategy outlined in the report is based on the following central view forecast, provided by our treasury management advisors (Capita), showing the movement in longer term interest rates for borrowing and movement in shorter term interest rates for investments.

Capita Asset Services Interest Rate View													
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank Rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
3m LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6m LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12m LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

12.2 The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

12.3 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

12.4 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

12.5 PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

12.6 The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

12.7 Investment returns are likely to remain low during 2017/18 and beyond. Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a ‘hard Brexit’, the fall in the value of sterling, and an increase in inflation expectations. 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 capital expenditure and/or to refinance maturing debt;

12.8 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

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13. INVESTMENTS

13.1 The primary objectives of the Council’s investment strategy are safeguarding the re-payment of the principal and interest of its investments on time, then ensuring adequate liquidity, with the investment rate of return being the final consideration. The current investment climate continues to have one over-riding risk, counterparty risk. As a result of these underlying concerns officers are implementing a risk averse operational investment strategy.

13.2 The 2011 revised CIPFA Treasury Management Code and the CLG Investment Guidance requires the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are a requirement to Member reporting, although the application of these is more subjective in nature. Additional background on the approach taken is attached at **Appendix C**.

13.3 These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.03% historic risk of default when compared to the whole portfolio.

Liquidity – In respect of this area the Council seeks to maintain:

- Bank overdraft - £1.60m
- Liquid short term deposits of at least £5m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.25 years, with a maximum of 0.625 years

Yield - Local measures of yield benchmark is:

- Investments – Internal returns above the 7 day LIBID rate
- And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.067%	0.189%	0.356%	0.551%	0.775%

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

13.4 Normally when the Council has surplus cash, this is invested to try to ensure that interest earned is optimised with minimal risk of capital loss. Higher interest rates are earned by investing any large amounts on the London money markets, rather than by leaving such sums with the Council's own bank. The Investment Strategy sets out the type of institutions with which the Council may deposit funds for this purpose. The list has been compiled to reflect the creditworthiness of these banks and building societies, rather than the rates of interest payable, as the safety of the asset is the most important consideration. Nonetheless, the interest received from these institutions is competitive.

13.5 The ongoing financial uncertainty has reinforced the need for the Council to ensure it adopts a security based approach to investment strategy.

13.6 Due to concerns over the risk of counterparties in the financial markets, the Council has acted to ensure investments are only placed for durations of up to one year. By keeping to a short duration the Council is reducing the risk that it holds an investment with a bank that no longer meets its minimum credit rating criteria and ensuring that the security of the investment is the Council's highest priority.

13.7 If market conditions significantly improve, we could make strategic investments up to £30m for more than 12 months, as reported in the Budget Report 2017/18 - Prudential Indicators and Limits (**Appendix xx**).

13.8 In recent years the Council has had a high level of investments and therefore the investment strategy has been aligned with our debt strategy. The strategy for repayment of debt has been dependent on the movement of long term interest rates, and in favourable circumstances this could mean the repayment of tranches of debt. Investments have therefore been managed in-house in order to finance any repayments if necessary. It is expected that this strategy will continue.

13.9 As established in the Mid-Year Treasury Management Activities Report, the Council applies the creditworthiness service provided by its advisors, Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

13.10 The Council also holds investments in Money Market Funds which are AAA rated and act, in a similar way to unit trusts, to spread the risk of default across a number of underlying institutions. This type of fund is tightly regulated and viewed as a relatively safer investment.

13.11 The Council has a deposit account with the Government Debt Management Office (DMO). As this facility is underwritten by the government, the rates of interest offered by the DMO are substantially below the current market rates. This facility has not been used in 2016/17.

13.12 If concerns over counterparty risk reduce and market conditions are judged suitable, long term borrowing may be taken up by the Council in advance of when it is required for capital purposes. In these circumstances the excess cash will be invested in line with the Council's prudent investment objectives, with security of the asset the highest priority. However, the Council is not allowed to borrow for the express purpose of reinvesting this cash to make a return.

13.13 Although security and liquidity are both given priority over yield, the Council still manages to achieve a higher rate of return than the 7 day LIBID benchmark. In 2015/16 the Council achieved a return of 0.47% versus a LIBID of 0.37%. This equated to £742k of interest, against £571k at LIBID, a difference of £171k.

14 INVESTMENTS – PROPOSED CHANGES

It is proposed that the following changes are made to the Council's investment strategy:

14.1 Counterparty Limits

It is proposed that the counterparty limit is changed to £50m for UK Government bodies (e.g. local authorities and other similar bodies). Any such investments will be highly secure due to the Government-backed nature of these entities.

In line with this it is proposed that the limit for total investments for more than 12 months is increased from £30m to £50m and that the limit for investments in non-specified investments is increased from 25% to 50%.

14.2 Alternative Investments

A new class of "alternative investments" is added to the available list of non-specified investment instruments. These instruments offer increased returns in the current low interest rate environment whilst still meeting the DCLG requirements for security, liquidity and yield

This would include asset backed securities and asset backed pooled investment funds, which are secured against real assets such as green energy, timber or property.

Any proposed investment of this nature would be the subject of a further report.

15 TREASURY MANAGEMENT ADVISORS

15.1 The Council uses Capita as its treasury management advisors. Capita provides a range of services which include:

- Technical support on treasury matters and capital finance issues;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and
- Credit ratings/market information service comprising the three main credit rating agencies.

15.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Council. This service is subject to regular review.

15.3 Tameside MBC and Capita recently agreed a new 4 year contract which runs to September 2019.

16. RECOMMENDATIONS

16.1 That the report be noted and the proposed borrowing strategy be supported.

16.2 That the Annual Investment Strategy be recommended for approval by the full Council

APPENDIX A

ANNUAL INVESTMENT STRATEGY: FINANCIAL YEAR 2017-18

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, and 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. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; 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.

Investment Objectives:

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.

All investments will be in sterling. The general policy objective for this Council is the prudent investment of its treasury balances. This includes monies borrowed for the purposes of expenditure in the reasonably near future (i.e. borrowed 12-18 months in advance of need). The Council's investment priorities are

(a) the **security** of capital and
(b) **liquidity** of its investments.
(c) **optimum return** on its investments commensurate with (a) and (b).

The former ODPM regulations stated that the borrowing of monies purely to invest or on-lend and make a return is unlawful, and therefore this Council will not engage in such activity.

Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years (UK Government debt or equivalent.
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

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

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

All institutions which meet the criteria **may** be included on our lending list at the discretion of the Section 151 Officer, although meeting the criteria does not guarantee this.

The criteria may only be changed by the Executive Cabinet.

Monitoring of credit ratings and other market information:

All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of Capita's creditworthiness service.

If a counterparty or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria or other market information leads the concerns over the credit quality of that entity, then the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately (however, existing fixed investments must remain in place until they mature).

If a counterparty is upgraded so that it fulfils the Council's criteria, its inclusion may be considered by the Section 151 Officer for approval.

Institutional Limits for Investments:
The Council has previously set limits on investments with individual institutions. These have been set for the Council and the Pension Fund combined. These limits (which will remain in force unless changed by the Executive Cabinet) are:

Currently the overall limit invested by Tameside, the GM Pension Fund and the GMMDAF in one institution should not exceed a combined amount of £70m. Of this £70m, a maximum of £50m may be invested by the Pension Fund, £15m by Tameside and £5m by the GMMDAF.

At any time the maximum should not exceed 20% of the total amount available for investment (at the time of the investment - individually for the Council and the Pension Fund), or the above limits, whichever is less. However, where total investments are less than £100m for the Pension Fund and £25m for Tameside, the upper limits will be £20m and £5m respectively.

It is proposed that these limits are amended and the counterparty limit for UK Government bodies (e.g. local authorities and other similar bodies) is increased to £50m. Any such investment would still be highly secure due to the Government-backed nature of these entities.

Investments defined as capital expenditure:
The acquisition of share capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'. The acquisition of loan capital in a body corporate has recently been relaxed so that it is not treated as capital expenditure and can be used for treasury management activities.

A loan or grant by this Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by this Council. It is therefore important for this Council to clearly identify if the loan has made for policy reasons (e.g. to a registered social landlord for the construction/improvement of dwellings) or an investment for treasury management purposes. The latter will be governed by the framework set by the Council for 'specified' and 'non-specified' investments.

The Council provided a loan of £4.280m (funded by Prudential Borrowing) to the Tameside Sports Trust in 2008/09, to invest in the refurbishment of three existing Leisure Centres within the Borough. This loan was for policy reasons and not for treasury management purposes. The Council also has an investment in Manchester Airport shares of £10.215m. These investments were not part of the Treasury Management strategy.

During 2009/10, Manchester Airport re-negotiated the terms of its loan arrangement with the 10 Greater Manchester Districts; as a result of this agreement the 10 Districts have taken responsibility to service the former Manchester Airport share of the GMMDAF and Terminal 2 Loan Debt. The Airport pays the Districts an annual fixed interest of 12% on the outstanding balance at 9 February 2010. The Airport has agreed to repay the loan to the Council by the end of the agreement in 2055. The re-negotiated loan arrangement was not for treasury management purposes.

The Council participates in the Local Authority Mortgage Scheme. Under this scheme the Council is required to place funds of £1m, with Lloyds Banking Group for a period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified investment categories.

Manchester Airport
Tameside MBC holds a 3.22% equity share in Manchester Airports Group (MAG). The fair value of the Council's 3.22% shareholding at 31 March 2016 has been estimated at £39.8m (£41.0m as at 31 March 2015).

Dividends of £4m were received in 2016/17 from the Council's investment in MAG. This revenue is included in the Council's Medium Term Financial Strategy as a key item of income.

Provisions for Credit-related losses
If any of the Council's investments appeared at risk of loss due to default (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

Investment Strategy to be followed:
Based on its cash flow forecasts, the Council anticipates its fund balances in 2016/17 to range between £90m and £210m.

Use of investments for rescheduling purposes, or deferring borrowing could substantially reduce these holdings, whereas borrowing earlier than required could increase them.

The minimum percentage of its overall investments that the Council will hold in short-term investments is 75%.

The current financial climate provides operational difficulties. Ideally investments would be invested longer to secure better returns, however uncertainty over counterparty creditworthiness suggest shorter dated investments would provide better security.

The money market interest rates will be constantly monitored, and with the advice of our treasury advisors, the length of investments will be determined in accordance with our own views of future rate movements. In this way we would hope to optimise our investment returns.

Use of Specified and Non-Specified Investments during the Financial Year

There are a number of types of investments which the Council could use. These are outlined in the following tables

Specified investments:
All such investments shall be in sterling with a maximum maturity of 1 year with institutions of high credit quality.

	Minimum Credit Criteria
Term Deposits (including bank cancellable deposits and certificates of deposit) with credit – rated deposit takers (banks and building societies) *	Per Capita Asset Services
Term Deposits with the UK Government including Treasury Bills or other Local Authorities	N/A
Money Market Funds	AAA
Debt Management Agency Deposit Facility	N/A

*If forward deposits are made, these will be for a maximum of 1 year from the date of the deal.

Bank cancellable deposits cover a variety of bank deposits where the bank holding the deposit, has the option of repaying at pre-specified times. Such investments normally attract a higher original interest rate.

Non – Specified Investments:
A maximum of 25% (at the time the investments are made) will be held in aggregate in non – specified investments The only types of non-specified investments, with high credit quality, that the Council may use during 2017/18 are:

	Minimum Credit Criteria
Term Deposits exceeding 1 year (including bank cancellable deposits) with credit – rated deposit takers (banks and building societies)	Per Capita Asset Services
Term Deposits with the UK Government or other Local Authorities exceeding 1 year	N/A
UK nationalised and part nationalised banks (currently Lloyds Banking Group and Royal Bank of Scotland Group) – investments will be limited to a maximum period of 12 months	N/A
The Council's own bankers if they fail to meet the basic credit criteria.	N/A

Investments of this nature will only be made with the approval of the Section 151 Officer and in line with our treasury management advisors' investment recommendations.

Alternative Investments

It is proposed that a new class of "alternative investments" be added to the Council's list of non-specified investment instruments.

The motivation for this is increased diversification from the current concentration of credit risk on financial institutions, along with the potential for increased returns in the current low interest rate environment whilst still meeting the DCLG requirements regarding security, liquidity, and yield.

A variety of products are available that are secured against real assets such as green energy, timber, leisure, commercial property and private real estate. Thorough due diligence will need to be undertaken on any such products before any investment is made.

The available products fall within two categories; asset backed securities and asset backed pooled investment funds.

Asset backed securities are typically bespoke structures and can be unrated. This increases the need for due diligence, which will likely involve legal advice and also that of external auditors.
Asset backed pooled investment funds involve the purchase of shares in a pooled fund or "fund of funds". These are less bespoke and require less due diligence.

APPENDIX B

Credit and Counterparty Risk Management

Specified Investments:
All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' quality criteria where applicable.

Non-Specified Investments:
These are any investments which do not meet the specified investment criteria or exceeding one year, as outlined in the body of the report. A maximum of 25% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**Max. maturity period**
DMADF – UK Government	N/A	**6 months**
UK Government gilts	UK sovereign rating	12 months
UK Government Treasury bills	UK sovereign rating	12 months
Bonds issued by multilateral development banks	AAA	6 months
Money market funds	AAA	Liquid
Enhanced money market funds with a credit score of 1.25	AAA	Liquid
Enhanced money market funds with a credit score of 1.5	AAA	Liquid
Local authorities	N/A	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	

APPENDIX C

Security, Liquidity and Yield Benchmarking

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield – This benchmarks is currently widely used to assess investment performance.

- Investments – Internal returns above the 7 day LIBID rate

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators.

Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts 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" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank overdraft - £1.600m
- Liquid short term deposits of at least £5m available with a week's notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk.

- WAL benchmark is expected to be 0.25 years, with a maximum of 0.625 years.

Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poor's long term rating category within each year according to the maturity of the investment.

Years	1	2	3	4	5
AAA	0.04%	0.10%	0.18%	0.27%	0.37%
AA	0.01%	0.02%	0.08%	0.16%	0.23%
A	0.07%	0.19%	0.36%	0.55%	0.77%

As set out earlier, the Council's minimum long term rating will typically be "A-" meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.07% of the total investment (e.g. for a £1m investment the average loss would be £700). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- 0.03% historic risk of default when compared to the whole portfolio.

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.067%	0.189%	0.356%	0.551%	0.775%

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Investment Annual Report. As this data is collated, trends and analysis will be collected and reported.