

Report of the Cabinet Member for Finance, Performance and Customer Services

## **Treasury Management Strategy Statement and Prudential Indicators for 2014/15 to 2018/19**

### **Report Summary**

1. The purpose of this report is to ask the Cabinet to recommend that Council approve the:
  - Integrated treasury management strategy statement including the annual investment strategy and the minimum revenue provision policy statement;
  - Prudential indicators for 2014/15 to 2018/19
  - Revised treasury management policy statement
  - Specified and non-specified investments schedule
  - Treasury management scheme of delegation and role of the section 151 officer

### **Background**

2. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first function of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
3. The second main function of the treasury management service is the funding of the Council's capital programme. The capital programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

4. CIPFA (Chartered Institute of Public Finance and Accountancy) defines treasury management as:

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

### **Reporting requirements**

5. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. The three reports are:
  - a) **Treasury management strategy statement and prudential indicators report** (this report) – which covers the capital plans including prudential indicators, the minimum revenue provision policy, the treasury management strategy, the annual investment strategy;
  - b) **A Mid Year Treasury Management Report** – updates members with whether the treasury activities are meeting the strategy, whether any policies require revision, amending prudential indicators if necessary;
  - c) **An Annual Treasury Report** – updates on treasury activity/ operations for the year and compares actual prudential indicators with estimates in the strategy.
6. These reports are required to be adequately scrutinised by committee before being recommended to the Council. The scrutiny role is undertaken by the Audit & Governance Committee.
7. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The training needs of treasury management officers is also periodically reviewed.

## **Treasury Management Strategy for 2014/15**

8. The treasury management strategy for 2014/15 covers two main areas:

a) Capital Issues 2014/15 to 2018/19 -

- Prudential Indicators relating to the Capital Programme;
- Minimum Revenue Provision (MRP) Policy Statement .
- Prudential Indicators to assess affordability of the Capital programme

b) Treasury management Issues – Treasury Management Strategy

- Prudential Indicators which will limit the treasury management risk and activities of the Council;
- the current treasury position;
- Economic background and prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- investment policy;
- creditworthiness policy;
- investment strategy;
- policy on use of external service providers;
- Scheme of delegation and the role of the S151 officer

9. These elements cover the statutory and regulatory requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Communities and Local Government (CLG) Minimum Revenue Provision (MRP) Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

## **The Capital Prudential Indicators 2014/15 – 2018/19**

10. The Council's capital expenditure plans are the key driver of treasury management activity. The Council's capital expenditure plans are the subject of a separate report on this agenda: the Capital Programme Budget 2014/15 to 2018/19. The output of the capital programme is reflected in this report in the capital prudential indicators, which are designed to assist

member's overview of the council's capital programme to ensure that the capital expenditure plans are affordable, sustainable and prudent.

11. The capital prudential indicators (PI) along with the treasury management prudential indicators (PI) are included throughout the report:

- PI 1: Capital expenditure
- PI 2: Capital financing requirement
- PI 3: Ratio of financing cost to net revenue stream
- PI4a&b: Incremental impact of capital investment decisions on council tax and housing rent
- PI 6a: Authorised limit for external debt
- PI 6b: Operational boundary for external debt
- PI 6c: Housing Revenue Account (HRA) debt Limit
- PI 7: Interest rate exposure for fixed and variable rated debt
- PI 8: Maturity structure of debt
- PI 9: Surplus funds invested >364 days

12. **Prudential Indicator 1 - Capital Expenditure.** This prudential Indicator is a summary of the Council's capital expenditure plans forming part of this budget cycle, 2013/14 is included as a comparator with detail in relation to scheme specifics provided in the Capital Monitor 3 and Capital Strategy 14/15 to 18/19 report:

<b>Capital Expenditure</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
General Fund (Non HRA)	51.326	49.589	36.497	25.378	14.852	6.795
Housing Revenue Account	9.588	14.471	10.287	8.701	7.528	8.548
<b>Total</b>	<b>60.914</b>	<b>64.060</b>	<b>46.784</b>	<b>34.079</b>	<b>22.380</b>	<b>15.343</b>

**Table 1: Capital Expenditure**

13. Table 1 details the capital expenditure of the Council excluding other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. There are no new PFI schemes forecast to be taken in 2014/15.

- 14. Prudential Indicator 2 - The Capital Financing Requirement (CFR) (Council's Borrowing Need);** the second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need for capital purposes. Any capital expenditure above, which has not immediately been paid for and will be funded by borrowing, will increase the CFR.
15. The CFR does not increase indefinitely, because the minimum revenue provision (MRP) is a statutory annual revenue charge, which broadly reduces the borrowing need in line with each assets life. Therefore, the CFR is reduced with this provision to repay debt.
16. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increases the CFR, and therefore the Council's overall borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has a limit to cover such schemes of £20m included within the CFR. AS set out in paragraph 35 table 7 the projected level of debt is significantly below the CFR over the 5 year period.

Table 2 below, shows the Capital Financing Requirement, excluding other long term liabilities:

<b>Capital Financing Requirement</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
<b>Non-HRA CFR</b>	<b>180.685</b>	<b>193.198</b>	<b>196.434</b>	<b>196.336</b>	<b>192.482</b>	<b>188.301</b>
HRA existing	18.794	18.794	18.794	18.794	18.794	18.794
HRA settlement	121.550	121.550	121.550	121.550	121.550	121.550
<b>HRA CFR</b>	<b>140.344</b>	<b>140.344</b>	<b>140.344</b>	<b>140.344</b>	<b>140.344</b>	<b>140.344</b>
<b>Total CFR</b>	<b>321.029</b>	<b>333.542</b>	<b>336,778</b>	<b>336.680</b>	<b>332.826</b>	<b>328.645</b>

Table 2: Capital Financing Requirement (CFR)

## Minimum Revenue Provision (MRP) Policy Statement

17. The Council is required to pay off an element of the accumulated General Fund (non-HRA) capital expenditure each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
18. CLG Regulations (statutory Instrument (SI) 2008 no.414 s4) require full Council to approve an MRP Statement in advance of each year. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period that is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The options presented are the same as in previous years and set out in paragraphs 19 & 21.
19. Full Council is requested to approve the following MRP Statement: For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
  - **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (S28 in SI 2003 no. 3146)
20. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.
21. From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be
  - **Asset Life Method** (Option 3)– MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);
22. This option provides for a reduction in the borrowing need over approximately the asset's life. The asset life is an absolute maximum and wherever possible the debt should be repaid over a shorter period. Estimated asset life periods will be determined

under delegated powers. It should be noted that with all debts, the longer the repayment period the higher the amount of interest incurred over the period of the loan accordingly, it is deemed as prudent to reduce the period over which the repayments are made.

23. In accordance with the requirements of The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 no MRP is chargeable on the HRA in the next 5 years. Under the HRA reform the HRA will be required to charge depreciation on its assets, which will have an increased revenue cost effect. In order to address any possible adverse impact in the next 4 years, regulations allow the Major Repairs Allowance to be used as a proxy for depreciation and for the depreciation charge to be reversed therefore, having no revenue impact on council tax. Further clarification on depreciation will be provided in future years.

24. Repayments included in annual PFI or finance leases are also applied as MRP.

### **Affordability Prudential Indicators**

25. Affordability Prudential Indicators - The prudential indicators mentioned so far in the report cover the overall capital programme and the control of borrowing through the capital financing requirement (CFR). In addition, it is necessary to assess the affordability of the Council's capital investment plans. These prudential indicators provide an indication of the impact of the capital programme investment plans on the Council's overall finances.

26. **Prudential Indicator 3 - Ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) and compares it to the Council's net revenue stream.

Financing Costs	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Non-HRA	10.86	12.78	14.02	14.14	14.17	14.24
HRA	14.26	13.54	13.57	13.54	13.51	13.48

Table 3: Ratio of financing costs to net revenue stream

27. The estimates of financing costs include current commitments and the proposals in the Capital Programme Budget 2014/15 to 2018/19 report on this agenda.

28. **Prudential Indicator 4 - Incremental impact of capital investment decisions on council tax.** This indicator identifies the revenue costs associated with proposed changes to the five-year capital programme recommended in the Capital programme 2014/15 to 2018/19 report in the table below. The assumptions are based on the budget figures as set out per the capital and financial strategy reports on this agenda.

Incremental Impact on Council tax – band D	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Incremental impact	n/a	£7.23	£4.58	£1.95	£2.78	£6.64

Table 4: - Incremental impact of capital investment decisions on the band D council tax

29. **Prudential Indicator 5 - Incremental impact of capital investment decisions on housing rent levels.** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the capital programme budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels. This indicator is zero as the housing rent levels are set by Government and is not directly impacted by the Council's capital plans.



Incremental Impact	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Weekly Housing Rents	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00

Table 5 - Incremental impact of capital investment decisions on housing rent levels

### Treasury Management Strategy

30. The capital prudential indicators set out above ensure that the Council's capital programme / expenditure plans are affordable, sustainable and prudent. The treasury management function ensures that the Council's cash is available to meet the Council's capital programme requirements and also revenue activity needs in accordance with the Local Government Act 2003 and relevant professional codes.

31. The treasury management function involves both the forecasting of the cash flow and, where capital plans are require, the organisation of appropriate borrowing facilities. The strategy covers the prudential / treasury indicators, the current and projected debt positions and the annual investment strategy.

### Current Portfolio Position

32. The Council's treasury portfolio position at 31 December 2013 is detailed below in table 6:

Institution Type	Principal	Average Rate
<u>Public Works Loan Board (PWLB)</u> – Money borrowed from the Debt Mgt Office (Treasury Agency)	£238.615m	3.614%
<u>Market Loans</u>		
Club Loan – A loan taken in conjunction with 2 other Authorities	£10.000m	7.155%
LOBO Loans (2) – Lender Option Borrower Option	£10.000m	3.740%
<b>Total Gross Borrowing (GF &amp; HRA)</b>	<b>£258.615m</b>	<b>3.756%</b>
<b>Total Investments</b>	<b>£48.572m</b>	

Table 6: Current position at 31 December 2013

33. The Council at 31 December 2013 had £258.615m of fixed interest rate debt, of which £139.941m was HRA and £118.674m General Fund. The cash balance available for investment was £48.572m. The level of investments shows a small decline reflecting no new borrowing being undertaken during 2013/14 to date and the capital programme continues to spend.

34. Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total gross debt, does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year 2012/13 plus the estimates of any additional CFR for 2013/14 and the following two financial years. This allows the flexibility to borrow in advance of need and ensures that borrowing is for a capital purpose and that borrowing is not undertaken for revenue purposes.

35. Table 7 shows that the estimated gross debt position of the Council does not exceed the underlying capital borrowing need (the CFR). The Director of Customer Business & Support Services (S151 Officer) confirms that the Council complied with this prudential indicator and does not envisage difficulties for the future.

	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
External Debt per maturity Profile	<b>258.615</b>	<b>258.615</b>	<b>294.115</b>	<b>294.115</b>	<b>302.115</b>	<b>300.115</b>
Expected Net Change in Debt	0.000	35.500	0.000	8.000	(2.000)	0.000
<b>Gross Projected Debt</b>	<b>258.615</b>	<b>294.115</b>	<b>294.115</b>	<b>302.115</b>	<b>300.115</b>	<b>300.115</b>
Total CFR	321.029	333.542	336.778	336.680	332.826	328.645
<b>Under/(over) Borrowed</b>	<b>Under</b>	<b>Under</b>	<b>Under</b>	<b>Under</b>	<b>Under</b>	<b>Under</b>

Table 7: External Debt < Capital Financing Requirement

36. Table 7 demonstrates that based on borrowing estimates there is a significant gap between actual borrowing and the CFR (driven by the use of internal funds to finance capital expenditure). The decision as to whether to continue to do this will take into account current (and future) assumptions re borrowing rates, and levels of internal reserves and balances held by the Council. The figures above show a reduction between CFR and external debt, however this will be determined by the S151 officer and the figure above is a current broad assumption and actual borrowing will be determined by the circumstances that prevail at the time eg borrowing rates, levels of cash balances

### **Prudential Indicators: Limits on Authority to Borrow**

37. **Prudential Indicator 6A – Authorised Borrowing Limit** - It is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Authorised Borrowing Limit”, and represents a control on the maximum level of debt. This is a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

<b>Authorised Limit</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
Borrowing	321.029	333.542	336.778	336.680	332.826	328.645
Other Long Term Liabilities	30.000	30.000	30.000	30.000	30.000	30.000
<b>Total</b>	<b>361.029</b>	<b>373.542</b>	<b>376.778</b>	<b>376.680</b>	<b>372.826</b>	<b>368.645</b>

Table 8: Authorised Borrowing Limit

38. **Prudential Indicator 6B – Operational Boundary**. In addition to the “Authorised Borrowing Limit”, there is a limit, which is the maximum level of debt allowed for, on an ongoing operational purpose. This is the Operational Boundary. The Operational Boundary in reality would only be breached because of in year

cash flow movements. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

<b>Operational Boundary</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
Borrowing	321.029	333.542	336.778	336.680	332.826	328.645
Other Long Term Liabilities	10.000	10.000	10.000	10.000	10.000	10.000
<b>Total</b>	<b>331.029</b>	<b>343.542</b>	<b>346.778</b>	<b>346.680</b>	<b>342.826</b>	<b>338.645</b>

Table 9: Operational Boundary

39. Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime, known as the HRA Debt Limit. This limit is currently:

<b>HRA Debt Limit £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
<b>Total HRA</b>	<b>145.97</b>	<b>145.97</b>	<b>145.97</b>	<b>145.97</b>	<b>145.97</b>	<b>145.97</b>

Table 10: HRA Debt Limit

### **Economic Background**

40. The economic situation is the background to which all treasury management activities operate. It assists in the formation of the treasury management strategy as it details the current economic and market environment.

### **Prospects for Interest Rates**

41. Current interest rates and the future direction of both long term and short term interest rates have a major influence on the overall treasury management strategy and affects both investment and borrowing decisions. To facilitate treasury management officers in making informed investment and borrowing decisions, the Council contracts Capita Asset Services as its treasury adviser. Part of their service is to assist the Council in formulating a view on interest rates. Annex A draws together a number of current City forecasts for short

term (Bank Rate) and longer fixed interests rates. Table 11 gives Capita's central view:

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

Table 11 – Capita's Bank Rate forecast for financial year ends

42. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history.

However, growth has rebounded during 2013 to surpass all expectations. Growth prospects remain strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

43. There are, therefore, concerns that a UK recovery currently based mainly on consumer spending and the housing market, may not endure much beyond 2014. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

44. The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of government debt to GDP ratios, in some countries, continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2014/15 and beyond;
- Borrowing interest rates have risen significantly during 2013 and are on a rising trend. 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 even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

### **Borrowing Strategy**

45. The Council undertakes long term borrowing in accordance with the capital expenditure requirements of the capital programme. The Council's borrowing requirement is known as the Capital Financing Requirement (CFR) as explained above in paragraph 14. As a result of the capital programme 2014/15 to 2018/19 the borrowing is projected to increase by £16.375m over the next 5 years. The CFR (the Council's actual need to borrow) does not necessarily increase by this £16.375m as a minimum amount of revenue provision is set aside every year in accordance with statutory requirement and this therefore reduces the actual amount that is required to be borrowed.

46. The borrowing strategy takes into account the borrowing requirement, the current economic and market environments and is also influenced by the above interest rate forecast. 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 supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains prudent as investment returns are low and counterparty risk is relatively high.
47. It is therefore beneficial to have a borrowing strategy where consideration is given to taking some longer term borrowing if favourable rates arise and also use some cash reserves. External borrowing will be considered throughout the financial year when interest rates seem most favourable. A target interest rate in light of table 11 above is 4.75%. This will enable borrowing to be taken through the year at different time periods. Consideration will also be given to the maturity profile of the debt portfolio so the Council is not exposed to the concentration of debt being in any one year.
48. Against this background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Director of Customer Business and Support Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- if it was felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
  - if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

49. The HRA strategy in 2013/14 for borrowing will be the same as the borrowing strategy described above for the whole Council. The HRA Business Plan will guide and influence the overall HRA borrowing strategy.

50. All decisions will be reported to the appropriate decision making body – Cabinet and Audit and Governance Committee - at the next available opportunity.

### **Prudential Indicators – Limits on Borrowing Activity**

51. There are three debt / borrowing related prudential indicators. The purpose of these are to constrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. This gross limit is set to reduce the Council's exposure to large fixed rate sums falling due for refinancing in a confined number of years.

52. These three debt/borrowing related prudential indicators are calculated to include the debt undertaken for the HRA as well as the remaining borrowing debt portfolio.

<b>Interest rate Exposure</b>	<b>2014/15 Estimate £m</b>	<b>2015/16 Estimate £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	<b>116%</b>	<b>109%</b>	<b>109%</b>	<b>109%</b>	<b>107%</b>
<b>Limits on variable interest rates based on net debt</b>	<b>-16%</b>	<b>-9%</b>	<b>-9%</b>	<b>-9%</b>	<b>-7%</b>
<b>Maturity Structure of borrowing 2012/13</b>					
	<b>Lower</b>			<b>Upper</b>	



Under 12 months	0%	30%	
12 months to 2 years	0%	30%	
2 years to 5 years	0%	40%	
5 years to 10 years	0%	40%	
10 years and above	30%	90%	

Table 12: Limits on Interest rate exposure and the Maturity Structure of Borrowing

### **Policy on Borrowing in Advance of Need**

53. Under Local Authorities (Capital Finance and Accounting) (England) Regulations 2008 regulation, the Council can borrow in advance of need in line with its future borrowing requirements in accordance with the Capital Financing Requirement. Any borrowing decision in advance of need will be considered carefully to ensure that value for money can be demonstrated, it is affordable, sustainable & prudent, that the treasury management revenue budget can support the borrowing finance costs in the longer term and that the Council can ensure the security of such funds if invested.
54. Borrowing in advance will be made within the constraints of the CIPFA Prudential Code that ensures that total gross debt, does not, except in the short term, exceed the total of the CFR in the preceding year 2013/14 plus the estimates of any additional CFR for 2014/15 and the following two financial years.
55. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **Debt Rescheduling**

56. As shown in table 11 and generally reflective of the long term pricing of risk, the forecasts show that short term borrowing rates will be considerably cheaper than longer term fixed interest rates in the foreseeable future. Therefore, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury management position, the short term nature of the loans, the costs of premiums involved in premature repayment for existing

debt and the likely cost of refinancing those short-term loans, once they mature. Debt rescheduling will also be considered for the HRA and the costs and benefits assessed to ensure value for money.

57. The reasons for any rescheduling to take place will include:

- a) the generation of cash savings and / or discounted cash flow savings;
- b) helping to fulfil the strategy outlined above, and
- c) enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

58. Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

59. Any rescheduling will be reported to Cabinet and/or Audit and Governance Committee, in accordance with the usual monitoring cycle.

## **Annual Investment Strategy**

### **Investment Policy**

60. The Council's investment policy has regard to the Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") and the 2011 CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

61. The Council's investment priorities are the security of capital and liquidity of its investments. The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies specifically to invest or lend on and make a return is unlawful and the Council will not engage in such activity.

62. In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using Capita's ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
63. Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end, the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings that show the varying degrees of suggested creditworthiness.
64. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.
65. Investment instruments identified for use in the financial year are listed in annex B under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set out in the later section - the Investment Strategy.
66. The Council continues to take a prudent approach to investing funds as set out in the Creditworthiness Policy below.

## Creditworthiness Policy

67. This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modeling approach with 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

68. This modelling approach combines credit ratings, credit watches, credit outlooks in a weighted scoring system which is then combined with an overlay of CDS (Credit Default Swap) spreads for which the end product is a series of colour code bands, which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years \*
- 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

*\*This category is for UK Government debt or its equivalent; constant NAV money market funds and collateralised deposits where the collateral is UK Govt debt*

69. The Capita Asset Services creditworthiness model uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.
70. Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalent) of Short Term rating F1, Long Term rating A-, Viability ratings of A-, and a Support rating of 1. 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.
71. All credit ratings will be monitored on an ongoing basis as information is provided weekly basis and also adhoc. The Council is alerted to changes to ratings of all three agencies through its use of the Capita's 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 against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.
72. Although sole reliance is not be placed on the use of this external service as the Council uses market data and market information, information on government support for banks and the credit ratings of that supporting government, the suitability of counterpatys is based heavily on Capitas advice.
73. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that

qualify using this credit criteria as at the date of this report are shown in Annex C. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

## **Investment Strategy**

74. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). The Council uses matrices (determined by the maximum cash balance in a given year) that stipulate both time and financial limits in order to spread counterparty (credit) risk when investing money with approved counterparties. The matrix is based on the projected average balance for the year. Therefore for 2014/15 the average balance is forecast to be between a low point of £10m and £62m, the matrix stipulates use of level 6 (maximum cash balance of between £50m - £60m, note this is the highest matrix Treasury officers feel is prudent to use) that results in a limit of £10m for counterparties with a durational band of 100 days and £15m for counterparties with a durational band of longer than 100 days.

75. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from Qtr 2 of 2016. Bank rate forecasts for financial year ends (March) are:

2013/14	0.50%
2014/15	0.50%
2015/16	0.50%
2016/17	1.25%

76. There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

77. For its cash flow generated balances, the Council will seek to utilise a combination of business reserve accounts (call accounts), 15 to 30 day notice accounts, short dated fixed term deposits and money market funds. In addition, the Council will look for investment opportunities in longer dated term deals

with specific counterparties that offer enhanced rates for Local Authority investment. All investment will be undertaken in accordance with the creditworthiness policy set out above.

78. The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next four years are as follows:

2014/15	0.50%
2015/16	0.50%
2016/17	1.00%
2017/18	2.00%

79. Therefore for 2013/14, the Council has budgeted for an investment return target of 0.50% on investments placed during the financial year and uses the 7 day LIBID rate as a benchmark for the rate of return on investment.

80. **Prudential Indicator 9** - total principal investment funds invested for greater than 364 days. This limit is set with regards to the Council's liquidity requirements and are based on the availability of funds after each year-end. A maximum principal sum to be invested for greater than 364 days is £10m.

81. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report. It should be noted that the Investment policy, creditworthiness policy and investment strategy are applicable to the Council's overall surplus funds and are also pertinent to the HRA.

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

82. The Council uses Capita Asset Services as its external treasury management advisors.

83. 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.

84. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

### **Scheme of Delegation and the Role of the Section 151 Officer**

85. Those charged with governance are responsible for the treasury management activities and are clearly defined within the organisation. Attached at Annex D are the Treasury Management Scheme of Delegation and also the Treasury Management role of the section 151 officer (Director of Customer & Business Support Services).

### **Consultation and Options**

86. The treasury management function of any business is a highly technical area, where decisions are often taken at very short notice in reaction to the financial markets. Therefore, to enable effective treasury management, all operational decisions are delegated by the Council to the Director of Customer & Business Support Services, who operates within the framework set out in this strategy and through the Treasury Management Policies and Practices. In order to inform sound treasury management operations the Council works with its Treasury Management advisers, Capita Asset Services. Capita Asset Services offers the Council a comprehensive information and advisory service that facilitates the Council in maximising its investment returns and minimise the costs of its debts.

87. Treasury Management strategy and activity is influenced by the capital investment and revenue spending decisions made by the Council. Both the revenue and capital budgets have been through a corporate process of consultation and consideration by the elected politicians. The revenue budget and capital budget proposals are included within this agenda.

88. At a strategic level, there are a number of treasury management options available that depend on the Council's stance on interest rate movements. The report sets out the



Council's stance and recommends the setting of key trigger points for borrowing and investing over the forthcoming financial year.

### **Council Plan**

89. The Treasury Management Strategy Statement and Prudential Indicators are aimed at ensuring the Council maximises its return on investments and minimises the cost of its debts whilst operating in a financial environment that safeguards the Council's funds. This will allow more resources to be freed up to invest in the Council's priorities, values and imperatives, as set out in the Council's Plan.

### **Implications**

#### **Financial**

90. The revenue implications of the treasury strategy are set out in the Revenue Budget report also on this agenda. The capital implications that drive the CFR are set out in the Capital Programme Budget report.

#### **Human Resources (HR)**

91. There are no HR implications as a result of this report

#### **Equalities**

92. There are no equalities implications as a result of this report

#### **Legal Implications**

93. Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

### **Crime and Disorder**

94. There are no crime and disorder implications as a result of this report

### **Information Technology (IT)**

95. There are no information technology implications as a result of this report

### **Property**

96. There are no property implications as a result of this report

### **Risk Management**

97. The treasury management function is a high-risk area because of the volume and level of large money transactions. As a result of this the Local Government Act 2003 (as amended), supporting regulations, the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice (the code) are all adhered to as required.

### **Recommendations**

98. The Cabinet are asked to recommend that Council approve:
- a. The proposed Treasury Management Strategy for 2014/15 including the annual investment strategy and the minimum revenue provision policy statement;
  - b. The Prudential Indicators for 2014/15 to 2018/19 in the main body of the report;
  - c. The Specified and Non-Specified Investments schedule (Annex B)
  - d. The Scheme of Delegation and the Role of the Section 151 Officer (Annex D)

Reason: To enable the continued effective operation of the Treasury Management function and ensure that all Council borrowing is prudent, affordable and sustainable.

<b>Author of the report:</b>	<b>Cabinet Member &amp; Chief Officer Responsible for the report:</b>			
Ross Brown Principal Accountant Ext 1207	Cabinet Member for Finance, Performance and Customer Services			
Debbie Mitchell Finance Manager	Ian Floyd Director of Customer & Business Support Services			
	<b>Report Approved</b>	√	<b>Date</b>	17/01/14
<b>Wards Affected: Not Applicable</b>				
<b><u>For further information please contact the author of the report</u></b>				

<b><u>Specialist Implications:</u></b>
Legal – Author of the report
Property – Not Applicable
Information Technology – Not Applicable

**For further information please contact the author of the report**

### **Background Papers**

Prudential indicator workings 2014/15 to 2018/19.

Capital Strategy 2014/15 to 2018/19 report.

Capita -treasury management advisers commentary.

### **Annexes**

Annex A – Interest Rate Forecast

Annex B – Specified and Non-Specified Investments categories  
Schedule

Annex C – Approved countries for investments

Annex D – Scheme of Delegation and the Role of the Section 151  
Officer