ITEM NO	

REPORT TO THE EXECUTIVE

DATE	**18th February 2013**
PORTFOLIO	**Resources & Performance Management**
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2013/14 Treasury Management Strategy and 2013/14 – 2015/16 Prudential and Treasury Indicators

PURPOSE

1.
- To comply with the amended Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011.
- To outline a treasury management strategy statement for the financial year 2013/14.
- To set out prudential indicators for the financial years 2013/16 in line with the Prudential Code.
- To seek approval for the Council's Minimum Revenue Provision (MRP) Policy Statement for the financial year 2013/14 in accordance with Government regulations

RECOMMENDATION

2. That the Executive recommend to Full Council approval of ;

   a) The treasury management strategy statement for 2013/14 as set out in paragraphs 5 to 8 of this report in compliance with the requirements of the CIPFA Code.

   b) The prudential and treasury indicators for 2013/14 to 2015/16 per Appendix 1 including the authorised limit for external debt of £30.650m.

   c) The revised list of Counterparties for Deposits outlined within Appendix 2.

   d) The Council's MRP Statement for 2013/14 as set out in paragraph 7 of this report.

REASONS FOR RECOMMENDATION

3. To fulfil statutory and regulatory requirements and to provide a clear framework for local authority capital finance and treasury management.

To provide the proper basis required by current Government regulations and guidance to make charges for debt repayment (MRP) to the Council's revenue account.

SUMMARY OF KEY POINTS

4. **Background**

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

As a consequence treasury management is defined 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."

5. **Introduction**

Full Council adopted on the 23rd February 2012 the CIPFA Treasury Management Code of Practice 2011 which has been updated in 2012, and is required to adopt a Treasury Management Strategy each year in advance of the forthcoming year. This report sets out the Treasury Management Strategy Statement for 2013/14 as well as the Prudential and Treasury Indicators for 2013/14 to 2015/16.

The primary requirements of the Code are as follows:

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.

- Treasury strategy and prudential and treasury indicators (this report) covering:
    1. the capital plans (including prudential indicators);
    2. a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
    3. the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
    4. an investment strategy (the parameters on how investments are to be managed).

- A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy being met or whether any policies require revision.
- An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy during the previous year.

Scrutiny

Full Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Resources Scrutiny Committee, and for the execution and administration of treasury management decisions to the Director of Resources, who will act in accordance with the Council's policy statement and TMP's and CIPFA's Standard of Professional Practice on Treasury Management.

6. Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital Issues

- The capital plans and the prudential indicators;
- The MRP strategy.

Treasury Management Issues

- The current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the strategy for deposits;
- creditworthiness policy; and
- policy on the use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Department of Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

7. **Capital issues**

The Capital Prudential Indicators 2013/14 – 2015/16 (See Table 1 in Appendix 1)

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

Capital Expenditure. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Programmed Spend	6,975	12,012	24,573	6,446	1,864
Financed by:					
Capital receipts	521	1,144	1,807	2,046	620
3rd Party Contributions	511	467	1,820	140	140
Capital grants	4,067	9,358	20,684	1,559	861
Revenue	660	354	61	176	118
Net financing need for the year	1,216	689	201	2,525	125

Ratio of Financing Costs to Net Revenue Streams

This indicator shows the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) expressed as a percentage against the net revenue stream (revenue spending power). Table 1 in Appendix 1 shows there is a general trend that financing costs are taking up a higher percentage of the revenue budget. This is due to forecast reductions in future aggregate external funding based on 'revenue spending power' for the Council through reduced Government grant.

The Council's Borrowing Need (the Capital Financing Requirement)
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. Any capital expenditure above, which has not immediately been paid for, will increase the CFR and is represented by the net financing need for the year line. The Council's CFR is shown in Table 1 of Appendix 1 and below.

The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

£m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
Total CFR	28,089	27,556	26,537	27,901	26,626
Net financing need for the year	21	(533)	(1,019)	1,364	(1,275)

£m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Movement in CFR represented by					
Net financing need for the year (above)	1,216	689	201	2,525	125
Less MRP and other financing movements	(1,195)	(1,222)	(1,220)	(1,161)	(1,400)
Movement in CFR	21	(533)	(1,019)	1,364	(1,275)

Incremental Impact of Capital Investment Decisions on Council Tax

This indicator identifies the revenue costs associated with the proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The costs include the investment interest to be foregone by using capital receipts and the proposed revenue contributions to capital (RCCO). The costs are expressed as an amount per Band D property using the 2013/14 council tax base of 20,906 for comparative purposes.

Minimum Revenue Provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend 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).

CLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

<u>Annual Statement on Policy for Making Minimum Revenue Provision on Outstanding Debt (Annual MRP Statement)</u>

<u>Relating to the Financial Year 2013/14</u>

The Council's policy on making the minimum revenue provision (MRP) for the repayment of debt to be charged to the Council's revenue account for the financial year 2013/14 is as follows:

The MRP shall be calculated in accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 and the guidance issued under section 21(1A) of the Local Government Act 2003.

The MRP shall be calculated:

a) For capital expenditure incurred before 1 April 2008 on the basis of 4% applied to the Council's capital financing requirement as at 31 March 2013, plus

b) for capital expenditure funded from prudential borrowing in accordance with option 3 of the guidance for financial years 2008/2009 to 2011/2012 and assumed for 2012/2013.
   Calculated on the asset life method - using the equal instalment method. The calculation will divide the borrowing relating to each particular asset and divide this by the estimated life of the asset to produce an equal annual charge to the revenue account.

The total of a) and b) above will be the overall annual MRP.

8. Treasury Management Issues

Treasury Management Strategy

The capital expenditure plans set out in the paragraph above, provide details of the activity of the Council. The treasury management function ensures that the Council's cash is organised within the relevant professional codes, so that sufficient cash is available to meet these activities. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

The Council's Current Portfolio Position

Within the prudential indicators in Appendix 1 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 debt, net of any investments, does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. In the Council's case, the external debt of £19.9m is less than the CFR which ranges from £26.5m to £27.9m.

Treasury Limits for 2013/14 to 2015/16

It is a statutory duty under Section 3 of the Act 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".

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in Table 2 in Appendix 1 of this report outlining the prudential and treasury indicators for 2013/14 – 2015/16.

The Operational Boundary is the limit beyond which external debt is not normally expected to exceed and is normally similar to the CFR. It is proposed to set this at 5% above the CFR.

The Authorised Limit is a further key indicator representing a control on the maximum level of borrowing, 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, whilst not desired, could be afforded in the short term, but is not sustainable in the longer term. It has currently been set at 10% above the operational boundary and includes provision for 'unusual cash movements'.

Prospects for Interest Rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates and the table below summarises Sector's view.

Sector's interest rate forecast:

Annual Average %	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
Sept 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50
June 2015	1.00	2.30	4.40	4.60
Sept 2015	1.25	2.50	4.60	4.80
Dec 2015	1.50	2.70	4.80	5.00
March 2016	1.75	2.90	5.00	5.20

The Borrowing Strategy

The Council is currently maintaining an under-borrowed position which means that the capital borrowing need (the CFR), 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 is prudent as investment returns are low and counterparty risk is high.

The Director of Resources will monitor interest rates 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, then long term borrowings will be postponed,
- if it was felt that there was a significant risk of a much sharper rise than that currently forecast, then the portfolio will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap.
- will take a view on prevailing and perceived future interest rates and take decisions on whether to borrow longer-term or short-term accordingly whenever a borrowing requirement arises. As well as taking a view on the appropriate mix of fixed and variable interest rate exposure in the light of prevailing and perceived future market conditions.
- undertake a constant review of the Council's total external debt portfolio to determine the scope for any restructuring possibilities and make recommendations to Full Council accordingly.

Treasury Management - Limits on Activity

There are three debt related treasury activity limits, the purpose of which is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. The indicators are:

- Upper limits on variable rate exposure;
- Upper limits on fixed rate exposure;
- Maturity structure on borrowing limits which are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Borrowing Policy and Borrowing Requirement

The Council will not borrow more than or in advance of its need purely in order to profit from the investment of the extra sums borrowed.

The Council's maximum borrowing requirement (Authorised Limit for external debt) is £30.650m next year. This is limited to 10% above the operational boundary, which has been set at 5% above the CFR.

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

As short term borrowing rates will be considerably cheaper than longer term rates, 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 position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include: -

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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.

All rescheduling will be reported to the Council at the earliest meeting following its action.

Strategy for Deposits

Background:

There are strict limits in terms of the type of institution with which funds may be deposited and the length of time funds can be invested for. These limits are reviewed annually [as a minimum] and the current listing was approved by Full Council on 17th May 2012.

The Council's deposit priorities focus on;

- Security of Capital
- Liquidity, and
- Yield

The Council will also aim to achieve optimum return [yield] on deposits commensurate with proper levels of security and liquidity.

Monitoring Performance:

Within the counter parties listing we have retained a £10m limit with HSBC Bank plc, coinciding with retaining HSBC as the provider for administering the Council's banking facilities [contract renewed in December 2012 for a three year term]. As a result of negotiations with the bank, we now have a 'sweep' facility for our current account. This means that if we do not deposit monies with other counterparties but leave the balance with HSBC, they will automatically transfer the money into an interest earning deposit account. This account is effectively a call account whereby we can get the money back instantly if required. The current rate the Council is achieving on these deposits is higher than that achieved with some other counterparties. Therefore, it is now proposed to increase the limit the Council can deposit with HSBC from £10m to £15m.

Approved list of Counterparties for Deposits

As part of the Treasury Policy Statement as a minimum the approved list of counterparties are reviewed annually and reported to Council. As stated above, the current list was approved on 17th May 2012. It is proposed that the maximum amount that can be deposited with counterparties for a period exceeding 364 days and up to 2 years is limited to £4m in line with the revision which is shown in Appendix 2. In 2012/13, the Council made a deposit of £1m for one year. The interest rate on this deposit was 3% compared with an average rate earned on deposits as at the end of December 2012 of 1%.

Creditworthiness Policy

This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies – Fitch, Moodys and Standard and Poors, forming the core element.
However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (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, credit outlooks and CDS spreads in a weighted scoring system 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 and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The Council is alerted to changes to ratings of all three agencies through its use of the Sector 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 CDS 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.

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 government support for banks and the credit ratings of that government support.

Policy on the use of treasury management consultants

The Council uses Sector Treasury Services as its external treasury management advisors.

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.

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 Director of Resources / Head of Finance & Property Management through recommendations to Full 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 will be subject to regular review.

9. **Economic update**

(provided by the Council's external service providers, Sector Treasury Services):

1/ Global economy:

The **Eurozone sovereign debt crisis** has abated somewhat following the ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request and so surrendering its national sovereignty to IMF supervision. Sentiment in financial markets has improved considerably since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse.

The US economy has only been able to manage weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of quantitative easing (QE) combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. However, the housing market does look as if it has, at long last, reached the bottom and house prices are now on the up.

Hopes for a broad based recovery have, therefore, focused on the **emerging markets**. However, there are increasing concerns over flashing warning signs in various parts of the Chinese economy that indicate it may be heading for a hard landing rather than a gradual slow down.

2/ UK economy:

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector has rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had the time to make a significant impact. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE to stimulate economic activity regardless of any near-term optimism. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) is also effectively a further addition of QE.

Unemployment. The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years as over one million jobs have been created in the private sector in the last two years.

Inflation and Bank Rate. Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. However, inflation increased back to 2.7% in October though it is expected to fall back to reach the 2% target level within the two year horizon.

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

In Summary, *Sector's forward view is as follows:*

Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012.

Given the weak outlook for economic growth, Sector sees the prospects for any changes in Bank Rate before 2015 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. The interest rate forecast in this report represents a balance of downside and upside risks.

10. Icelandic Bank Deposit

Background:
An amount of £1m was deposited by the Council in September 2008 in an Icelandic bank, Landsbanki Islands HF. As a consequence of the collapse of the Icelandic banking system, this short-term deposit was not repaid on the due date of 8th October 2008.

Current Position:
It is estimated that 100% of the £1m deposit will ultimately be recovered as the Council's claim enjoys priority status. Total repayments of £431k have been received to date. £300k in February 2012, £123k in May 2012 and £58k in October 2012.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

10.
- The limit which can be deposited with the Council's bankers is to increase from £10m to £15m per Appendix 2.
- The maximum value of deposits over 364 days and up to 2 years is to be £4m (with a maximum of £2m with any one counterparty).
- The new limits for external debt for 2013/14 is to be £27.864m for the operational boundary and £30.650m for the authorised limit.
- Borrowing has a longer term impact on the revenue budget because of the costs of finance. The cost of borrowing is increasing as a percentage of the net revenue stream in future years because of the forecast reductions in the Council's 'net revenue spend'

POLICY IMPLICATIONS

11. Compliance with the revised CIPFA Code of Practice on Treasury Management.

DETAILS OF CONSULTATION

12. None.

BACKGROUND PAPERS

13. None

FURTHER INFORMATION	
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