

Essential Reference Paper “B”

TREASURY MANAGEMENT STRATEGY STATEMENT

AND

ANNUAL INVESTMENT STRATEGY

2015/16 to 2017/18

1 Introduction

1.1 Background

The Council's treasury management function ensures that cash is available when needed to fund revenue and capital expenditure. Surplus monies are invested in line with the council's risk management policy which matches expected returns to the level of risk taken within set limits.

The treasury management function also ensures that capital expenditure and the repayment of loans are funded in the medium to long term.

1.2 The Council defines its treasury management activities as:

'The management of the Council's investments and cash flows, its banking arrangements, money market and capital transactions: the effective control of the risks associated with these activities; and the pursuit of optimum returns consistent with the Council's risk management policy for treasury management.'

1.3 The Council's treasury management activities will be undertaken with regard to the following Treasury Management Strategic Principles:

- To achieve the minimum interest rate cost on external debt, whilst recognising the risk management implications;
- To protect the capital value of external investments and ensure the liquidity of the investments;
- To provide a return on investments which is maximised in relation to determined risk levels, security and liquidity requirements;
- To mitigate the risks associated with treasury management operations; and
- To seek to follow best practice in the administration of the treasury management function.

Monitoring of these strategic principles will be assessed by the forecasting and review of prudential indicators and associated reporting.

1.4 Statutory and CIPFA Requirements

The Council is required under the Local Government Act 2003 and associated regulations to 'have regard to' the requirements of the CIPFA Prudential Code and the CIPFA Treasury Management

Code of Practice in setting out its treasury management plans and arrangements for the next three years.

The Code's primary requirements are as follows:

- To set out a Treasury Management Policy Statement as detailed at paragraph 1.3 above;
- To set out a Treasury Strategy for borrowing and prepare an Annual Investment Strategy for a three year budgeting period;
- To create and maintain adequate Treasury Management Practices, setting out how treasury management activities will be managed and controlled.
- To ensure the organisations receives reports on its treasury management policies, practices and activities as a minimum: an annual strategy and plan in advance of the financial year, a mid year review of activity and an annual report.

2 Treasury Management Strategy for 2015/16 to 2017/18

2.1 The strategy covers three main areas:

Capital issues:

- *The Council's capital plans for the next three years and associated monitoring indicators; and*
- *The Minimum Revenue Provision (MRP) Policy.*

Treasury Management Issues:

- *Economic factors influencing the strategy;*
- *The Borrowing Strategy and associated risk management processes; and*
- *The Investment Strategy and associated risk management processes.*

Other:

- *External Treasury Management Advisors; and*
- *Governance Arrangements.*

2.2 In addition it is a statutory requirement that the strategy includes certain performance measures and limits called Prudential Indicators. The Prudential Indicators must be approved by Full Council before the beginning of each financial year. Their purpose

is to help the Council ensure that its capital investment plans are affordable, prudent and sustainable.

2.3 The headings listed in paragraph 2.1 comply with the necessary statutory regulations, CIPFA Codes of Practice and associated best practice guidance.

3 The Council's Capital Investment Plans – 2015/16 to 2017/18 (Prudential Indicator 1 – evaluation of prudence)

3.1 The capital budget recommended for approval by Council is detailed in Table 1: Prudential Indicators 1 and 2.

Table 1: Prudential Indicators 1 and 2			
	2015/16 estimate £000	2016/17 estimate £000	2017/18 estimate £000
Proposed Capital Programme	2,719	2,987	2,259
Financed by:			
Capital receipts	1,841	950	400
Capital grants	175	175	175
3rd party contributions	134	14	275
Revenue contributions	25	25	25
Net Financing Requirement in year	544	1,823	1,384
Capital financing requirement b/f	(41,343)	(40,799)	(41,330)
Capital financing requirement c/f	(40,799)	(38,976)	(39,946)

4 Council's Borrowing Need: Capital Financing Requirement (CFR) – 2015/16 to 2017/18 (Prudential Indicator 2 – evaluation of prudence)

4.1 The impact of the Council's capital investment plans on CFR is detailed in table 1: Prudential indicators 1 and 2.

4.2 CFR represents capital expenditure which has not been financed from revenue or other capital resources such as grants, capital receipts or 3rd party contributions etc. CFR is in effect the underlying need to borrow: that element of capital expenditure financed from both internal funding and external borrowing. Capital expenditure not financed from revenue or other capital sources will increase CFR. CFR is reduced annually by the statutory revenue charge for debt repayment – Minimum Revenue Provision (MRP), as detailed at paragraph 6. CFR is also increased by other types of finance such as the finance leases for the council's trade refuse vehicles and property assets.

4.3 The Council has a negative credit ceiling as a result of receipts received from the housing stock transfer in 2002. As the early

redemption of Council debt of £7.5 million continues to be expensive, the Council has been given a 'debt free' status by special determination.

- 4.4 The three year capital programme is funded only partially from revenue and other capital sources. The balance of capital investment will therefore increase CFR and, at some point in the future, return CFR to a positive position.
- 4.5 The increase in CFR can be met from external borrowing, or from internal funding i.e. the use of surplus cash.
- 4.6 Rates of interest on investments remain low compared to the cost of borrowing. The Council will therefore continue to finance the requirement from internal borrowing. The financial impact of this policy is a reduction in surplus cash available for investment, with associated loss of interest income.

5 Council's ability to support the borrowing requirement to finance the capital programme – (Prudential Indicator 3 and 4 –Affordability)

- 5.1 These 2 indicators assist the evaluation of the affordability of council's capital and borrowing decisions:

Ratio of financing costs to net revenue stream

This represents the estimated net financing costs for the year divided by the amount to be met from general revenue grants and local taxpayers.

Incremental impact of financing decisions on band D council tax

This represents an estimate of the incremental impact of new capital investment decisions on the annual Council Tax (Band D). It is intended to show the effect on the Council Tax of approving additional capital expenditure.

5.2 The ratios will fluctuate with changes to revenue and capital funding decisions and the capital programme. They are set out in Table 2: Prudential Indicators 3 and 4. They show that the Council's capital programme and level of borrowing are prudent and sustainable.

Table 2: Prudential Indicators 3 and 4			
	2015/16 estimate	2016/17 estimate	2017/18 estimate
Capital decisions affordability			
Ratio of finance costs to net revenue stream	4.79%	4.68%	4.45%
Incremental impact of financing decisions on band D council tax	£0.34	£0.38	£0.32

6 Council's Minimum Revenue Provision Policy

- 6.1 The Council is required by Statute to set aside some of its revenue as provision for the repayment of debt. In other words the Council is required to make an annual contribution to reduce its CFR. This set-aside is called the Minimum Revenue Provision (MRP). Statutory guidance requires Councils to set a prudent MRP charge.
- 6.2 Following the disposal of the Council's Housing Stock and the retention of outstanding debt, the Council has a negative CFR. MRP has therefore been set as nil.
- 6.3 The Council has the discretion to make a voluntary revenue contribution against the CFR if it decided that CFR was above a level considered prudent. Current financial plans do not include additional contributions.

7 Economic Background to Treasury Management Strategy

- 7.1 After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), it appears likely that strong growth will continue through 2014 and into 2015. The Office of Budget Responsibility (OBR) also raised its forecast for economic growth this year from 2.7% to 3.0%, and from 2.3% to 2.4% next year.
- 7.2 However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing

market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable.

- 7.3 Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years.
- 7.4 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.2% in September, the lowest rate since 2009. The OBR expects inflation measured by the consumer prices index (CPI) of 1.5% this year, 1.2% next year and 1.7% the year after. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.
- 7.5 The return to strong growth has also helped lower forecasts for the increase in Government debt over the next five years. However, monthly public sector deficit figures have disappointed so far in 2014/15 and government is expected to borrow more money this year than had previously been predicted. The OBR has raised its borrowing forecast for the current financial year from £86.6bn to £91.3bn, which is still below last year's total of £97.5bn.
- 7.6 The U.S. faces similar debt problems to those of 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.

7.7 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return.

7.8 In its report accompanying the Autumn Statement, the OBR warns that government's overall plan for spending on public services was to reduce it from £5,650 per head in 2009-10 to £3,880 per head in 2019-20. Total public spending is now projected to fall to 35.2% of GDP in 2019-20, taking it below the previous post-war lows reached in 1957-58 and 1999-00 to what would probably be its lowest level in 80 years. The OBR warns that only about 40% of this reduction will be made during the current Parliament, with the remaining 60% still to come in the next one.

7.9 Interest rate forecasts are set out in Table 3:

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
5 yr PWLB rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10 yr PWLB rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25 yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50 yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

8 Borrowing Strategy 2015/16 to 2017/18

8.1 Local Authorities undertake borrowing to:

- Finance capital expenditure not met from grants, capital receipts, development contributions etc;
- To replace maturing debt; and
- To finance cashflow in the short term.

8.2 Interest rate risk and a 'bunched' debt maturity portfolio are the key risks for the Council's borrowing strategy.

8.3 The Council can raise borrowing from a variety of sources. However, the Government's PWLB facility remains a low cost and flexible option for long term borrowing.

8.4 The strategy for the next 3 years is to finance capital expenditure and cashflows internally as set out in paragraph 4.6.

8.5 The Council's current debt portfolio comprises:

- £1.5 million of PWLB debt due to mature on 1st February 2055 at a fixed rate of 8.875%;

- £6 million loan with LGS Investment due to mature on 22 May 2020 at a fixed rate of 8.785%; and
- A finance lease with a financial value of £1.288 million as at 31st March 2014 for 10 Refuse Vehicles.

The Council's debt portfolio is not planned to change over the reporting period of this strategy.

8.6 Borrowing Prudential Indicators are included in Table 4: Prudential Indicators 5, 6, 7, 8, 9.

There are five debt related indicators:

- Limits for fixed interest rate exposure;
- Limits for variable rate exposure;
- Authorised Limit – which represents the total external debt and is the legal limit for external debt and long term credit arrangements;
- Operational Boundary – sets the annual external debt threshold. The indicator reflects the level of debt sustainable in the short term but not the long term;
- Limits for maturity structure of debt profile.

Table 4: Prudential Indicators 5,6,7,8,9			
Interest rates exposure	2015/16	2016/17	2017/18
Limits for fixed interest rate exposure on debt	100%	100%	100%
Limits for variable interest rate exposure on debt	50%	50%	50%
Authorised limit	£12.6m	£12.2m	£11.7m
Operational boundary	£8.4m	£8.1m	£7.8m
Limits for maturity structure of debt portfolio:	Lower	Upper	
Under 12 months	0%	20%	
12 months to 2 years	0%	25%	
2 years to 5 years	0%	40%	
5 years to 10 years	0%	50%	
10 years and above	0%	100%	

8.7 Policy on borrowing in advance of need:

The Council will not borrow more than or in advance of need purely in order to make a profit.

8.8 Debt Rescheduling

Due to high rates of interest on the outstanding £7.5 million of external debt and the expected low level of discount rates for maturities, any potential restructuring or premature repayment of

debt would be very expensive; as early repayment would attract premiums in excess of £1 million.

The situation will be kept under review in consultation with the Council's advisors and any changes or proposals will be reported to Council for consideration and approval.

8.9 Use of Financial Derivatives to manage interest rate risks

Under the General Power of Competence, the Localism Act 2011 granted local authorities, in theory, the power to use financial derivatives to manage interest rate risk. However, given that the power is not explicit and untested in the Courts; the Council does not intend to use these arrangements.

Should the situation change, the Council would be required to change the Strategy and develop a framework for the use of such instruments.

9 Investment Strategy 2015/16 to 2017/18

9.1 Primary Investment Principle

All external investments will be made in accordance with the Council's adopted investment policy, prevailing legislation and associated regulations.

9.2 In Line with CIPFA's Code of Practice and DCLG guidance, the Council's primary investment principle is to invest surplus funds giving priority to the security of the capital sum and liquidity; with the return on investment being commensurate to the security and liquidity required.

9.3 The council's investment portfolio as at 30 September 2014 is set out in Table 5 below.

Table 5	Balance as at 31 March 2014	Net Investments Made in Year	Balance as at 30 September 2014
Investment counterparties:			
Banks & building societies	£47.54m	6.87m	£54.41m
Money market funds	£9.96m	0m	£9.96m
Gilts and commercial paper	£6.79m	0.82m	£7.61m
Cash	£4.90m	(4.72m)	£0.18m
	<u>£69.19m</u>		<u>£72.16m</u>

9.4 Available Investment Vehicles

Under Statutory Regulations Local Authorities have a variety of treasury investment vehicles available to them to investment

surplus cash. The investment vehicles are split into 'Specified' investments and 'Non Specified' investments, the definition of each being:

- 'Specified' Investments are in Sterling, with a duration of no more than a year and meet the minimum 'high' quality criteria where applicable (Annex 1a);
- 'Non Specified' Investments are any other investments not meeting the specified criteria (Annex 1b).

9.5 The Council's Counter Party Listing also includes criteria for investment in non-Treasury investment vehicles such as Pooled Property Funds (Annex 1c). Investment is limited to £20m split between a maximum of two funds. At December 2014 the Council is on the waiting list for two funds with a current expected commencement date for the investments of September 2015.

9.6 Council's Creditworthiness Policy - Background

The Council applies the credit rating model provided by Capita Asset Services to select investment counterparties. The ratings are based on information from three key rating agencies (Fitch, Moods and Standard & Poors). The model also builds in any ratings watch information and credit outlooks, Credit Default Swap spread are used as an early warning of likely changes to credit ratings and sovereign ratings.

The model produces a coded banding system of creditworthiness and maximum investment duration for the council to consider.

The Council then sets maximum investment limits for group counterparties.

9.7 Regulatory change for Financial Institutions – implied sovereignty support.

The main Rating agencies (Fitch, Moody's and Standard & Poor's) have historically provided some institutions with a rating uplift due to implied levels of sovereign support. This is one of the many factors which currently influence the setting of credit ratings. As the regulatory regime changes, these implied sovereign support levels are going to be removed. New regulations are expected to provide a 'Bail in' provision for funding institutions; which requires holders of debt (including fixed term deposits) to bear the costs associated with an institutions collapse. Since most local authorities investments tend to be in fixed term deposits this will introduce a significant new credit risk for the Council.

9.8 The Treasury Strategy 2014-15 was revised to mitigate this new risk. Annex 1a, Annex 1b and Annex 1c reflect changes which have been discussed with the Council's treasury management adviser: Capita.

9.9 Regulatory change for Financial Institutions – Money Market Funds (MMF's) Credit ratings.

Further regulatory changes are proposed which will stop Money Market Funds from obtaining a credit rating. Once regulatory changes are enacted the Council will take advice from the Councils' treasury management advisors in respect of any existing and proposed new investments in Money Market Funds. Current arrangements will also be reviewed and revisions made to the Treasury Management strategy where necessary. These changes are reflected in Annex 1.

9.10 Investments - Assessing performance and monitoring risk

The Council has set an upper limit on sums invested in 'Non Specified' treasury investment vehicles for periods of longer than 364 days including an upper limit of 20% of the total annual treasury investment portfolio.

The Council has assumed an investment return of 1.12% (2015-16 and 2016-17) and 1.47% (2017-18) in the Medium Term Financial Plan.

Any material variations for the council's revenue budget as a result of lower investment returns will be met from the Interest Equalisation Reserve as agreed by Council. The balance on the reserve was £2.257 million as at 31 March 2014.

10 Policy on use of External Advisors

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

10.2 The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that reliance is not placed upon external service providers. There is a benefit in employing specialist treasury management providers to access up to date skills and knowledge.

11 Corporate Governance

11.1 Reporting requirements

As a minimum those charged with governance will receive and consider the following reports:

- The treasury management strategy and annual investment strategy for the forthcoming financial year and the following two financial years which is compliant with the CIPFA Code of Practice and best practice guidance;
- A mid-year treasury management report on progress against the target and indicators set in the strategy;
- An outturn report, to be received no later than six months after the end of the financial year;
- Healthcheck monitoring reports to CMT, Executive and Full Council will include material changes to investment returns in year and the impact of any changes to the council's external funding costs;
- The Investment Board meets on a regular basis to consider current investment arrangements.

11.2 Role of the Section 151 Officer

The Section 151 Officer is responsible for all monies in the hands of the Council. This includes the Treasury Management function.

This responsibility is incorporated into the Council's Financial Regulations.

11.3 The training needs for relevant officers involved in treasury operations will be regularly reviewed.