

## Treasury Management and Investment Strategy 2013/14 to 2015/16

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## 1. Summary

- 1.1 This report sets out the context within which the Council's treasury management activity operates and outlines a proposed strategy for the coming year. The report considers the Council's borrowing and investment strategy alongside required Prudential Indicators. It also identifies risk reduction strategies that have been established to ensure the fundamental aims of security, liquidity and only then the optimisation of yield are successfully executed.
- 1.2 The Council is required to actively manage its substantial cashflows on a daily basis. The need to place monies in investments or to borrow monies to finance capital programmes and to cover daily operational needs, is an integral part of daily cash and investment portfolio management. As at 31 March 2013 the Council's loan portfolio is expected to be £347m and the total value of investments are forecast to be £72m.
- 1.3 The Council's Capital Financing requirement (CFR) is a function of the Council's balance sheet and measures the underlying need to borrow for capital purposes. The projected CFR for 31 March 2013 is £425m, of which £179m is attributed to the General Fund (GF) with the remaining £246m within the Housing Revenue Account (HRA). The HRA CFR includes £191.6m of settlement debt undertaken in March 2012.
- 1.4 The Council's current and proposed ongoing strategy is to minimise borrowing to below the level of its net borrowing requirement. This is lower than the CFR and requires the use of internal borrowing. This approach reduces interest costs, lowers credit risk and relieves pressure on the Council's counterparty list. The debt portfolio will be monitored to take advantage of any potential refinancing opportunities that would deliver interest cost savings or rebalance the maturity structure of the portfolio.
- 1.5 Borrowing is restricted by two limits: the Authorised Limit, a statutory limit that sets the maximum level of external borrowing and the Operational Boundary, which is determined by both the estimated CFR and day to day cashflow movements. For 2013/14 the proposed Authorised Limit is £517m and the Operational Boundary is £487m.
- 1.6 In order to service the Council's day to day cash needs, the Council maintains a portfolio of short term investments and deposits. The Council's investment priorities are: the security of invested capital; the liquidity of invested capital; and the optimum yield that is commensurate with security and liquidity, in that order. This report details the Council's investment strategy, explains the counterparties with whom the Council is permitted to invest and the overall holdings with these institutions.
- 1.7 The security of any investment remains the primary consideration in decision making and a cautious approach is always adopted. Whilst this report identifies all permitted options in investment decision making, tighter controls govern daily activity limiting the number of counterparties with whom investments will be placed. Officers regularly monitor all institutions on the counterparty list and will maintain an extremely cautious approach in determining counterparties, maximum investment and length of investment.

- 1.8 Whilst potential developments to the investment strategy are monitored and reported throughout the year via monthly budget monitoring reports, continued pressure and uncertainty within the financial markets have led to no additions or extensions being proposed for the 2013/14 Strategy. However a number of long standing instruments have been removed as they are currently deemed unnecessary; these include multilateral development bank bonds, non UK government bonds and variable net asset value money market funds.

## **2. Background**

- 2.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to consider and publish a Treasury Management Strategy Statement (TMSS), Prudential Indicators and Minimum Revenue Provision (MRP) Statement on an annual basis. The TMSS also incorporates the Annual Investment Strategy as required under the CLG's Investment Guidance.
- 2.2. The Council's Treasury Management operations are fundamentally concerned with the management of risk. The Council is responsible for its treasury decisions, management of loan/investment portfolios and cashflow activities. Whilst the regulations and controls that the Council elects to put in place are designed to minimise or neutralise risk, no treasury management activity is completely devoid of risk.
- 2.3. The purpose of this TMSS is to facilitate Council to approve:
- Treasury Management Strategy for 2013/14
  - Annual Investment Strategy 2013/14
  - Prudential Indicators for 2013/14, 2014/15 and 2015/16
  - MRP Statement
- 2.4. These strategies are formulated in conjunction with the Council's Medium Term Financial Forecast (MTFF) and consider the impact on the Council's Revenue and Capital Budgets. Prudential Indicators and the forecast Treasury position, alongside the projected outlook for interest rates, are key economic drivers in the development of the Treasury Management Strategy.
- 2.5. There exist numerous safeguards and regulations for which local authorities must have regard when creating their treasury strategies. Hillingdon complies with all relevant statute, guidance and accounting standards and in general maintains a cautious, basic and transparent approach towards its treasury operations.
- 2.6. The average rate of interest paid on Council borrowing for 2012/13 will be 3.00% representing one of the lowest portfolio rates achieved in London in recent years. However, rates on investments are also very low and the Council's cautious strategy of only investing in highly rated UK banks has impacted returns resulting in an expected average rate of 0.67%. Rates are projected to be similar for 2013/14.

### 3. Balance Sheet and Treasury Position

- 3.1. The underlying need to borrow for capital purposes is reflected by the Capital Financing Requirement (CFR) which measures the cumulative capital expenditure that has not yet been financed from council resources. This, together with Balances and Reserves, are core drivers of treasury management activity. Estimates of the CFR, based on the projected Revenue Budget and Capital Programmes over the next three years are shown in Table 1.

**Table 1**

|  | <b>2012/13<br/>Estimate<br/>£m</b> | <b>2013/14<br/>Estimate<br/>£m</b> | <b>2014/15<br/>Estimate<br/>£m</b> | <b>2015/16<br/>Estimate<br/>£m</b> |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| General Fund CFR   | 179                                | 221                                | 226                                | 232                                |
| HRA CFR <sup>1</sup>   | 246                                | 251                                | 251                                | 243                                |
| <b>Total CFR</b>   | <b>425</b>                         | <b>472</b>                         | <b>477</b>                         | <b>475</b>                         |
| Existing Profile of Borrowing and Other Long Term Liabilities <sup>2</sup> | (349)                              | (339)                              | (329)                              | (317)                              |
| <b>Cumulative Maximum External Borrowing Requirement</b>                   | <b>76</b>                          | <b>133</b>                         | <b>148</b>                         | <b>158</b>                         |
| Usable Reserves <sup>3</sup>   | (47)                               | (39)                               | (36)                               | (34)                               |
| <b>Cumulative Net Borrowing Requirement</b>                                | <b>29</b>                          | <b>94</b>                          | <b>112</b>                         | <b>124</b>                         |

1. The HRA CFR includes £191.6m of borrowing paid to central government in settlement on the introduction of the self financing regime introduced in March 2012.
2. The existing profile of borrowing does not include potential LOBO loan maturities which may or may not occur. Over the next three years, loans totalling £10m, £11m and £13m respectively will be in a state of call. Other long term liabilities include commitments under finance leases and private finance initiatives (PFI's).
3. The balances and reserves figures quoted above relate to core General Fund and HRA balances only. They do not include those balances on the Balance Sheet where the Council has no direct control, such as schools' reserves.

- 3.2. The Cumulative Maximum External Borrowing Requirement shown in Table 1 represents the projected amount of internal borrowing (the difference between CFR and actual physical borrowing undertaken) and is determined by available balances and reserves, plus working capital generated via daily cashflow activity. The current portfolio position is set out in Appendix A. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining borrowing and investment decisions that are taken against the backdrop of the underlying Balance Sheet position. The Council will ensure that net physical external borrowing (i.e. net of investments) will not exceed the CFR other than for emergency short term cashflow requirements.
- 3.3. The Council's projected Capital programme over the next three years alongside the projected financing of this is fundamental in determining a borrowing strategy. The Prudential Indicators associated with capital expenditure projections and its incremental impact on council tax and housing rent levels are shown in Appendix B.

#### 4. Borrowing and Rescheduling Strategy

- 4.1. The Council's external debt at 31 March 2013 (gross borrowing plus other long term liabilities) will be £349.2m (Appendix A). This is currently considerably lower than both the Operational Boundary and Authorised Limit.
- 4.2. During 2012/13 £10.3m of borrowing was repaid through scheduled instalments and maturities with £6.8m attributable to the GF and £3.5m to the HRA. These repayment figures will be replicated during 2013/14.
- 4.3. The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is a statutory limit for borrowing determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Table 2

| <b>Authorised Limit for External Debt</b> | <b>2012/13 Approved £m</b> | <b>2013/14 Estimate £m</b> | <b>2014/15 Estimate £m</b> | <b>2015/16 Estimate £m</b> |
|---|----------------------------|----------------------------|----------------------------|----------------------------|
| Borrowing                                 | 496                        | 515                        | 513                        | 518                        |
| Other Long term Liabilities               | 3                          | 2                          | 2                          | 2                          |
| <b>Authorised Limit</b>                   | <b>499</b>                 | <b>517</b>                 | <b>515</b>                 | <b>520</b>                 |

- 4.4. The **Operational Boundary** is linked directly to the Council's estimates of the CFR and estimates of other day to day cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent scenario but without the additional headroom included within the Authorised Limit. This facilitates short term additional borrowing in the event of unforeseen adverse events.

Table 3

| <b>Operational Boundary for External Debt</b> | <b>2012/13 Approved £m</b> | <b>2013/14 Estimate £m</b> | <b>2014/15 Estimate £m</b> | <b>2015/16 Estimate £m</b> |
|---|----------------------------|----------------------------|----------------------------|----------------------------|
| Borrowing                                     | 466                        | 485                        | 483                        | 488                        |
| Other Long term Liabilities                   | 3                          | 2                          | 2                          | 2                          |
| <b>Operational Boundary</b>                   | <b>469</b>                 | <b>487</b>                 | <b>485</b>                 | <b>490</b>                 |

- 4.5. The Director of Finance has delegated authority, within the above limits, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Any such decisions will be based on the outcome of financial option appraisals and best value considerations based on current market and macroeconomic conditions. Cabinet is notified of any use of this delegated authority through monthly budget monitoring reports.

## Gross Debt compared to the Capital Financing Requirement

- 4.6. This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for capital purposes, councils should ensure that debt does not, except in the short term, exceed the total Capital Financing Requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. The Council's gross debt is projected to be £76m below the CFR as at March 2013.
- 4.7. The Director of Finance will report that the Council has had no difficulty meeting this requirement in 2012/13, nor are there any difficulties envisaged for future years.
- 4.8. **Sources of Borrowing:** The Council will keep under review the following borrowing options:
- Public Works Loan Board (PWLB) loans
  - Borrowing from other local authorities
  - Borrowing from institutions such as the European Investment Bank and directly from Commercial Institutions
  - Borrowing from the Money Markets
  - Capital Markets (stock issues, commercial paper and bills)
  - Local authority bills
  - Structured finance
  - Leasing
- 4.9. During 2012/13 the PWLB introduced a new "Certainty Rate" which allowed council's to avail themselves of a 0.2% reduction against normal PWLB lending rates if they were able to satisfy criteria regarding the use of future borrowing. The Council successfully applied for inclusion onto the "Certainty Rate" list of borrowers. Although a mix of borrowing options will always be considered, the PWLB will remain the primary source of borrowing whilst rates remain closely linked to government gilts that are at all time lows.
- 4.10. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:
- Variable rate borrowing
  - Medium-term Equal Instalments of Principal (EIP) or Annuity Loans
  - Long term Maturity loans, where affordable
- 4.11. Projected capital expenditure levels, market conditions and interest rate levels are monitored throughout the year in order to adapt borrowing strategies to minimise borrowing costs over the medium to longer term whilst maintaining financial stability. The differential between debt costs and investment earnings, despite long term borrowing rates being at low levels, remains acute and this is expected to remain a feature during 2013/14. The 'cost of carry' associated with medium and long term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short term costs. The use of internal resources in lieu of borrowing may again, in 2013/14, be the most cost effective means of financing capital expenditure, however it is projected these will not fully defer the

borrowing requirement and new loans of £30m are anticipated to be undertaken towards the end of the year. Financing costs associated with these are factored into future year's revenue budgets via the MTFF process.

- 4.12. PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. The use of variable rate borrowing saves the Council revenue resources in the 'cost of carry' and is a very cheap form of finance. However this type of borrowing injects volatility into the debt portfolio in terms of interest rate risk and exposure to variable interest rates will be kept under regular review. The Council currently has variable rate borrowing of £51.3m (of which £40m is HRA) at a rate of 0.54%.
- 4.13. The Council has £48m of LOBO loans (Lender's Option Borrower's Option) of which £10m will be in their call period in 2013/14. In the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also the option of repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB. However the default response will be early repayment without penalty although it is highly unlikely that the loans will be called given interest rates are now lower than those at the inception of the loan.
- 4.14. There is a difference of £39m between the gross external borrowing requirement and the net external borrowing requirement represented by the Council's balances and reserves. Under current market conditions, the Council intends to maintain its present strategy to only borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's counterparty list and to avoid the 'cost of carry'.
- 4.15. **Debt Rescheduling:** The rationale for rescheduling would be one or more of the following:
  - Savings in interest costs with minimal risk
  - Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
  - Amending the profile of maturing debt to reduce any inherent refinancing risks.

Rates and markets are monitored daily by officers and the Council's treasury advisors to identify opportunities for rescheduling.

- 4.16. Any borrowing and rescheduling activity is reported in monthly budget monitoring to Cabinet. However, unless premiums are significantly reduced, it is unlikely any debt rescheduling will be undertaken.
- 4.17. Where temporary borrowing is required this will be attributed directly to either the GF or HRA pools. Interest costs will be separated between the two pools and allocated accordingly.
- 4.18. The following Prudential Indicators shows the extent to which the Council is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not unduly exposed to interest rate rises,

which could adversely impact its revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short term rates on investments.

**Table 4**

| Upper Limits for Interest Rate Exposure                         | Estimated Level (or benchmark level at 31/03/13 %) | 2012/13 Approved % | 2013/14 Estimate % | 2014/15 Estimate % | 2015/16 Estimate % |
|---|--|--------------------|--------------------|--------------------|--------------------|
| Upper Limit for Fixed Interest Rate Exposure on Debt            | 83   | 100                | 100                | 100                | 100                |
| Upper Limit for Fixed Interest Rate Exposure on Investments     | 0  | (75)               | (75)               | (75)               | (75)               |
| Upper Limit for Variable Interest Rate Exposure on Debt         | 17   | 50                 | 50                 | 50                 | 50                 |
| Upper Limit for Variable Interest Rate Exposure on Investments* | (100)  | (100)              | (100)              | (100)              | (100)              |

\*Investments with duration less than one year are classified as variable.

4.19. The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits shown in table 5 are intended to control excessive exposures to volatility in interest rates on the refinancing of maturing debt. The first scheduled LOBO call option has been included as the maturity date is within this indicator.

**Table 5**

| Maturity structure of fixed rate borrowing | PWLB Estimated level at 31/03/13 % | Market LOBO 1 <sup>st</sup> call option at 31/03/13 % | Lower Limit for 2013/14 % | Upper Limit for 2013/14 % |
|--|------------------------------------|---|---------------------------|---------------------------|
| under 12 months                            | 2.97                               | 3.38  | 0                         | 25                        |
| 12 months and within 24 months             | 2.63                               | 3.72  | 0                         | 25                        |
| 24 months and within 5 years               | 10.92                              | 9.12  | 0                         | 50                        |
| 5 years and within 10 years                | 21.10                              | 0.00  | 0                         | 100                       |
| 10 years and within 20 years               | 18.24                              | 0.00  | 0                         | 100                       |
| 20 years and within 30 years               | 18.26                              | 0.00  | 0                         | 100                       |
| 30 years and within 40 years               | 0.00                               | 0.00  | 0                         | 100                       |
| 40 years and within 50 years               | 9.66                               | 0.00  | 0                         | 100                       |
| 50 years and above                         | 0.00                               | 0.00  | 0                         | 100                       |
| <b>Total</b>                               | <b>83.78</b>                       | <b>16.22</b>  | <b>0</b>                  | <b>100</b>                |

## 5. Annual Investment Strategy

- 5.1. In accordance with Investment Guidance from CLG and best practice, the Council's primary objective in relation to the investment of public funds remains:
  - security of the invested capital;
  - liquidity of the invested capital;
  - an optimum yield which is commensurate with security and liquidity.
- 5.2. Investments are categorised as 'Specified' or 'Non Specified' based on the criteria set out in the CLG Guidance. Definitions of these and financial instruments for the Council's potential use within its investment strategy are contained in Appendix D. The Director of Finance under delegated powers will, on a daily operational basis determine the most appropriate form of investments in keeping with investment objectives, income and risk management requirements and with reference to the Prudential Indicators. Decisions concerning the core strategic investment portfolio will be reported monthly to Cabinet.
- 5.3. Financial markets remain in a state of volatility as a result of European difficulties, policy uncertainties in US and generally weakened forecasts for growth. It is against this backdrop of uncertainty that the Council's investment strategy is framed. No additions or extensions have been included in the 2013/14 strategy; however instruments including multilateral development bank bonds, non UK government bonds and variable net asset value money market funds (including collective investment schemes) have been removed.
- 5.4. The Council's estimated level of investments at 31 March 2013 is projected to be £72m (Appendix A).
- 5.5. The Council's in-house investments are made with reference to the outlook for the UK Bank Rate, money market rates and other macroeconomic factors. In any period of significant stress in the markets or heightened counterparty risk, the fall back position is for investments to be placed with central government's Debt Management Office (DMO) or to purchase UK Treasury Bills. The rates of interest from the DMO are below the equivalent money market rates, but this is an acceptable counterbalance for the guarantee that the Council's capital is secure.
- 5.6. Investment returns attributable to the HRA will be credited to the HRA and calculated in accordance to the CLG's Item 8 determination.
- 5.7. **Credit Risk:** The Council considers security, liquidity and yield, in that order when making daily investment decisions. Credit ratings remain an important element of assessing credit risk but they are not the sole feature in the assessment of counterparties. The Council also considers alternative assessments of credit strength and information including corporate intelligence and market sentiment towards counterparties. The following key tools are used to assess credit risk:
  - Credit Ratings - minimum long term A- or equivalent for counterparties; AA+ for non-UK sovereigns.
  - Credit Default Swaps (where quoted)
  - Economic fundamentals such as GDP; net debt as a percentage of GDP

- Sovereign support mechanisms/potential support from a well-resourced parent institution
- Share Prices (where quoted)
- Macroeconomic indicators
- Corporate developments, news articles and market sentiment.
- Subjective overlay

The Council will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

- 5.8. The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2013/14. Short term money market rates are likely to remain at very low levels for an extended period, which will have a significant impact on investment income. Projected future interest rates provided by the Council's treasury advisors are shown in Appendix C.
- 5.9. With short term interest rates forecast to be low for even longer, an investment strategy will typically result in a lengthening of investment periods, where cashflow and credit conditions permit, in order to lock in higher rates of acceptable risk adjusted returns.
- 5.10. In order to spread the investment portfolio, deposits will be placed with a range of approved counterparties designed to achieve a diversified portfolio of prudent counterparties, varying investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved and this is reviewed regularly.
- 5.11. Money market funds (MMFs) are utilised, but good treasury management practice prevails and, whilst MMFs provide good diversification, the Council will also seek to diversify any exposure by utilising more than one MMF. The Council will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. Where MMF's participate, the Council utilises the facilities of a MMF portal to make subscriptions and redemptions. The portal procedure involves the use a clearing agent however the Council's funds are ring fenced throughout the process.
- 5.12. **Investments which constitute capital expenditure:** Investments meeting the definition of capital expenditure can be financed from capital or revenue resources. They are also subject to the CLG's Guidance on "non-specified investments". The placing of such investments has accounting, financing and budgetary implications. Whilst it is permissible to fund capital investments by increasing the underlying need to borrow, it should be noted that under the CLG's Minimum Revenue Provision (MRP) Guidance, MRP should be applied over a 20 year period. The Council has determined that it is not currently prudent to make investments which constitute capital expenditure. These would presently need to be sourced from revenue and therefore the requirement for MRP would make the investment unviable.
- 5.13. **The use of financial instruments for the management of risk:** Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit.

Consequently, the Council does not intend to use derivatives. Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

5.14. The Council banks with HSBC Bank plc and it meets the minimum long term credit criteria of A- (or equivalent). If the credit rating falls below the Authority's minimum criteria, HSBC Bank plc will continue to be used for its banking activities, short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

5.15. The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. However, the Council's current strategy excludes investments for over a year and in the absence of borrowing in advance of need, this is likely to remain in place.

**Table 6**

| <b>Upper Limit for total principal sums invested over 364 days</b> | <b>2012/13 Approved £m</b> | <b>2013/14 Estimate £m</b> | <b>2014/15 Estimate £m</b> | <b>2015/16 Estimate £m</b> |
|--|----------------------------|----------------------------|----------------------------|----------------------------|
|  | <b>80</b>                  | <b>64</b>                  | <b>58</b>                  | <b>66</b>                  |

5.16. All investment activity will comply with the accounting requirements of the local authority IFRS based Code of Practice.

## **6. Outlook for Interest Rates**

6.1. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose, is attached at Appendix C. The Council also monitors other sources of market information and will reappraise its strategy from time to time and, if required, realign it with evolving market conditions and expectations for future interest rates.

## **7. Balanced Budget Requirement**

7.1. The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

## **8. Adoption of the CIPFA Treasury Management Code:**

8.1. The Council approved the adoption of the CIPFA Treasury Management Code at its full Council meeting on 23 Feb 2012.

## **9. 2013/14 MRP Statement**

9.1. The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision (MRP)

has been issued by the Secretary of State. Local authorities are required to “have regard” to such Guidance under section 21(1A) of the Local Government Act 2003.

9.2. The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

This does not preclude other prudent methods to provide for the repayment of debt principal.

9.3. MRP in 2013/14: Option 1 and 2 will be used for the majority of GF historic debt particularly that deemed to be supported through the Revenue Support Grant. For major projects where capital expenditure is funded from prudential borrowing Option 3 will be used to provide MRP over the life of the asset to which the borrowing was applied.

9.4. The HRA will make a form of MRP to pay down its self-financing settlement debt over the 30 year business cycle on which the settlement is based.

## **10. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators**

10.1. Treasury activity is monitored and reported to Senior Management on a daily and weekly basis. Monthly updates including Prudential Indicators are provided to Cabinet as part of the budget monitoring process.

10.2. The Treasury Management Strategy Statement (including Prudential Indicators and Annual Investment Strategy) for the forthcoming financial year is submitted to Cabinet prior to agreement at full Council before the start of the financial year. An early draft is provided to Audit Committee in December. Any amendments to the TMSS which are required during the year will be submitted to Cabinet for approval.

## **11. Other Items**

11.1. **Training:** CIPFA’s Code of Practice requires all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

11.2. The Council adopts a continuous performance and development programme to ensure officers are regularly appraised and any training needs addressed. Treasury Officers also attend regular training sessions, seminars and workshops. These ensure their knowledge is up to date and relevant. Details of training received are maintained as part of the performance and development process.

11.3. Council Members receive information regarding treasury management as part of their general finance training. Access to additional training is provided where required.

11.4. **Investment Consultants:** The Council has a contract in place with Arlingclose Ltd to provide a treasury advisory service, which details the agreed schedule of services. Performance is measured against the schedule of services to ensure the services being provided are in line with the agreement.

APPENDIX A

EXISTING PORTFOLIO PROJECTION

Table 7

|                                     | Estimated Portfolio<br>as at 31/03/13<br>£m |
|-------------------------------------|---|
| <b>External Borrowing:</b>          |   |
| Fixed Rate – PWLB                   | 248.0                                       |
| Fixed Rate – Market                 | 38.0  |
| Variable Rate – PWLB                | 50.5  |
| Variable Rate – Market              | 10.0  |
| <b>Total External Borrowing</b>     | <b>346.5</b>                                |
| <b>Other Long Term Liabilities:</b> |   |
| PFI                                 | 2.4   |
| Finance Leases                      | 0.3   |
| <b>Total Gross External Debt</b>    | <b>349.2</b>                                |
| <b>Investments:</b>                 |   |
| Short-term & Instant Access         | 72.0  |
| Long-term Investments               | 0.0   |
| <b>Total Investments</b>            | <b>72.0</b>                                 |

### Estimates of Capital Expenditure and other Prudential Indicators:

- i. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, Housing Rent levels. In an environment of 'low rates for longer' the Council's strategy is currently to defer external borrowing and use internal borrowing where possible, thus saving revenue interest cost of carry and simultaneously reducing counterparty investment risks.
- ii. Estimates for Capital expenditure shown in Table 8 are estimates of likely capital cash outflows.

**Table 8**

| Capital Expenditure | 2012/13 Approved £m | 2012/13 Revised £m | 2013/14 Estimate £m | 2014/15 Estimate £m | 2015/16 Estimate £m |
|---------------------|---------------------|--------------------|---------------------|---------------------|---------------------|
| General Fund        | 87.3                | 57.5               | 91.6                | 56.0                | 41.5                |
| HRA                 | 17.9                | 6.7                | 26.0                | 17.0                | 10.0                |
| <b>Total</b>        | <b>105.2</b>        | <b>64.2</b>        | <b>117.6</b>        | <b>73.0</b>         | <b>51.5</b>         |

- iii. Capital expenditure is expected to be financed as follows:

**Table 9**

| Capital Financing       | 2012/13 Approved £m | 2012/13 Revised £m | 2013/14 Estimate £m | 2014/15 Estimate £m | 2015/16 Estimate £m |
|-------------------------|---------------------|--------------------|---------------------|---------------------|---------------------|
| Capital Receipts        | 15.5                | 6.5                | 10.0                | 22.0                | 6.5                 |
| Government Grants       | 28.5                | 28.4               | 35.8                | 21.0                | 20.0                |
| Major Repairs Allowance | 8.3                 | 8.3                | 8.3                 | 8.4                 | 8.5                 |
| Revenue Contributions   | 2.4                 | 2.3                | 3.5                 | 2.5                 | 3.5                 |
| <b>Total Financing</b>  | <b>54.7</b>         | <b>45.5</b>        | <b>57.6</b>         | <b>53.9</b>         | <b>38.5</b>         |
| Other External Funding  | 3.3                 | -                  | -                   | -                   | -                   |
| Unsupported Borrowing   | 47.2                | 18.7               | 60.0                | 19.1                | 13.0                |
| <b>Total Funding</b>    | <b>50.5</b>         | <b>18.7</b>        | <b>60.0</b>         | <b>19.1</b>         | <b>13.0</b>         |
| <b>Total</b>            | <b>105.2</b>        | <b>64.2</b>        | <b>117.6</b>        | <b>73.0</b>         | <b>51.5</b>         |

- iv. **Actual External Debt:** This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

**Table 10**

| <b>Actual External Debt as at 31/03/2013</b> | <b>£m</b>    |
|--|--------------|
| Borrowing                                    | 346.5        |
| Other Long term Liabilities                  | 2.7          |
| <b>Total</b>                                 | <b>349.2</b> |

- v. **HRA Indebtedness:** Following settlement and the introduction of the self-financing regime, a borrowing cap of £303.3m has been imposed by HM Treasury on HRA indebtedness. This gives the HRA potential headroom borrowing of up to £50.2m to finance future capital programmes following the first settlement debt principal repayment in 2012/13.

**Incremental Impact of Capital Investment Decisions:**

- vi. As an indicator of affordability, Table 11 shows the notional impact of capital investment decisions on Council Tax and Housing Rent levels and represents the impact on these if the financing of the capital programme were to be funded from taxes and rents. However, in reality there are no consequential increases to Council Tax or Rents as much of the capital programme is funded from grants, the sale of released or newly created assets, revenue savings for invest to save schemes and additional rental income streams for HRA developments.
- vii. In addition, the notional increase shown in Council Tax is further exacerbated by reforms to the Council Tax benefit system which has the effect of reducing the tax base thus increasing the amount attributable to each band D property.

**Table 11**

| <b>Incremental Impact of Capital Investment Decisions</b> | <b>2013/14 Estimate</b> | <b>2014/15 Estimate</b> | <b>2015/16 Estimate</b> |
|---|-------------------------|-------------------------|-------------------------|
| Increase in Band D Council Tax                            | £15.27                  | £1.20                   | £13.18                  |
| Increase in Average Weekly Housing Rents                  | £1.20                   | £1.06                   | (£0.34)                 |

- viii. The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of future revenue budgets required to meet borrowing costs. The ratio is based on costs net of investment income.

**Table 12**

| <b>Ratio of Financing Costs to Net Revenue Stream</b> | <b>2012/13 Approved %</b> | <b>2012/13 Revised %</b> | <b>2013/14 Estimate %</b> | <b>2014/15 Estimate %</b> | <b>2015/16 Estimate %</b> |
|---|---------------------------|--------------------------|---------------------------|---------------------------|---------------------------|
| General Fund  | 4.00                      | 3.58                     | 3.83                      | 4.05                      | 4.78                      |
| HRA   | 28.11                     | 19.58                    | 20.05                     | 20.36                     | 19.46                     |
| <b>Weighted Average</b>                               | <b>9.07</b>               | <b>6.80</b>              | <b>7.30</b>               | <b>7.72</b>               | <b>8.24</b>               |

## Arlingclose's Economic and Interest Rate Forecast

Table 13

|                           | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 | Mar-16 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>Official Bank Rate</b> |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               |        |        | 0.25   | 0.25   | 0.25   | 0.25   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   |
| Central case              | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   |
| Downside risk             |        | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |
| <b>3-month LIBID</b>      |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               | 0.25   | 0.25   | 0.25   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.75   | 0.75   | 0.75   | 0.75   | 0.75   |
| Central case              | 0.40   | 0.40   | 0.40   | 0.45   | 0.45   | 0.50   | 0.50   | 0.50   | 0.55   | 0.55   | 0.55   | 0.60   | 0.60   |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |
| <b>1-yr LIBID</b>         |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.75   | 0.75   | 0.75   | 0.75   | 0.75   |
| Central case              | 0.85   | 0.90   | 0.95   | 0.95   | 1.00   | 1.00   | 1.00   | 1.00   | 1.10   | 1.10   | 1.10   | 1.10   | 1.10   |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |
| <b>5-yr gilt</b>          |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               | 0.50   | 0.50   | 0.50   | 0.50   | 0.75   | 0.75   | 0.75   | 0.75   | 1.00   | 1.00   | 1.00   | 1.00   | 1.00   |
| Central case              | 0.95   | 0.95   | 0.95   | 0.95   | 1.00   | 1.00   | 1.00   | 1.00   | 1.10   | 1.10   | 1.10   | 1.20   | 1.20   |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |
| <b>10-yr gilt</b>         |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.75   | 0.75   | 1.00   | 1.00   | 1.00   | 1.00   |
| Central case              | 2.00   | 2.00   | 2.05   | 2.05   | 2.05   | 2.05   | 2.10   | 2.10   | 2.10   | 2.20   | 2.20   | 2.20   | 2.20   |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |
| <b>20-yr gilt</b>         |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               | 0.50   | 0.50   | 0.50   | 0.50   | 0.75   | 0.75   | 0.75   | 0.75   | 1.00   | 1.00   | 1.00   | 1.00   | 1.00   |
| Central case              | 2.90   | 2.90   | 2.90   | 2.90   | 3.00   | 3.00   | 3.00   | 3.00   | 3.10   | 3.10   | 3.10   | 3.10   | 3.10   |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |
| <b>50-yr gilt</b>         |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Upside risk               | 0.50   | 0.50   | 0.50   | 0.50   | 0.75   | 0.75   | 0.75   | 0.75   | 0.75   | 1.00   | 1.00   | 1.00   | 1.00   |
| Central case              | 3.35   | 3.35   | 3.35   | 3.40   | 3.40   | 3.40   | 3.50   | 3.50   | 3.50   | 3.50   | 3.60   | 3.60   | 3.60   |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  |

**Underlying Assumptions:**

UK growth is unlikely to return to above trend for the foreseeable future. Q3 GDP was strong at 0.9% but this momentum is unlikely to be sustained in Q4 or in 2013. The rebalancing from public-sector driven consumption to private sector demand and investment is yet to manifest, and there is little sign of productivity growth. Further contraction in the Eurozone, including Germany's powerful economy, and slower forecast growth in the emerging economies (Brazil/Mexico/India) are exacerbating the weakness.

Consumer Price Inflation has fallen to 2.7 % from a peak of 5.2%. Near term CPI is likely to be affected by volatility in commodity prices and its decrease towards the 2% target is expected to be slower than previously estimated. Real wage growth (i.e. after inflation) is forecast to remain weak.

The fiscal outlook for bringing down the structural deficit and stabilise debt levels remains very challenging. Weakened credibility of the UK reining its levels of debt poses a risk to the AAA status, but recent history (US, France) suggests this may not automatically result in a sell-off in gilts.

In the absence of large, unexpected decline in growth, QE is likely to remain on hold at £375bn for now. The availability of cheaper bank borrowing and subsequently for corporates through the Funding for Lending Scheme (FLS) is a supporting factor.

The US Federal Reserve's shift in its rate guidance from a date-based indication to economic thresholds (6.5% unemployment, inflation 1 – 2 years out projected to remain below 2.5%, longer term inflation expectations remain well anchored) is likely to increase market uncertainty around the highly volatile US employment data releases.

The Eurozone is making slow headway which has curtailed some of the immediate risks although peripheral countries continue to struggle. Fully-fledged banking and fiscal union is still some years away.

In the US, the issues of spending cuts, reducing the budget deficit and raising the country's debt ceiling remain unresolved. A failure to address these by March 2013 could lead to a similar showdown and risks a downgrade to the US sovereign credit rating by one or more agencies.

A reversal in market risk sentiment from current "risk on" to "risk off" could be triggered by economic and/or political events – impending Italian and German elections, US debt ceiling impasse, difficulty surrounding Cyprus' bailout, and contagion returning the haunt the European peripheral nations – could inject renewed volatility into gilts and sovereign bonds.

## **Specified Investments & Non Specified Investments**

Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the “high credit quality” as decided by the Council and are not deemed capital expenditure investments under Statute.

Non Specified Investments are those which do not meet the above criteria, for example more than 1 year in duration. However the Council has determined that the “high credit quality” criterion will still need to be satisfied.

### **Specified Investments identified for use by the Council**

“Specified” Investments identified for the Council’s use are:

- Deposits in the DMO’s Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- Certificates of deposit with banks and building societies
- Gilts: (bonds issued by the UK government)
- Bonds issued by multilateral development banks
- Treasury Bills (T-Bills)
- Local Authority Bills
- Corporate Bonds
- Commercial Paper
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)

When determining the minimum acceptable credit quality the Council will not only consider the credit rating criteria below but also information on corporate developments of and market sentiment towards investment counterparties as set out in the Credit Risk indicator.

For credit rated counterparties, the minimum criteria will be the lowest equivalent long term ratings assigned by Fitch, Moody’s and Standard & Poor’s (where assigned). Long term minimum: A-(Fitch); A3 (Moody’s); A- (S&P).

Specified investments will be made within the following limits:

**Table 14**

| <b>Instrument</b>                | <b>Country/<br/>Domicile</b>           | <b>Counterparty</b>  | <b>Maximum<br/>Counterparty<br/>Limits %/£m</b> |
|----------------------------------|--|--|---|
| Term Deposits                    | UK                                     | DMADF, DMO   | No limit  |
| Term Deposits/Call Accounts      | UK                                     | Other UK Local Authorities   | £35m per Local Authority / No total limit       |
| Term Deposits/Call Accounts/CD's | UK                                     | Counterparties rated at least A- Long Term (or equivalent)   | 15% / £20m                                      |
| Term Deposits/Call Accounts/CD's | Non-UK                                 | Counterparties rated at least A- (or equivalent) in select countries with a Sovereign Rating of at least AA+ | 15% / £15m                                      |
| Gilts                            | UK                                     | DMO  | No limit  |
| Treasury Bills                   | UK                                     | DMO  | No limit  |
| Local Authority Bills            | UK                                     | Other UK Local Authorities   | No limit  |
| AAA-rated Money Market Funds     | UK/Ireland/<br>Luxembourg<br>domiciled | CNAV MMFs (Constant Net Asset Value Money Market Funds)  | 10% / £7.5m per fund. Maximum MMF exposure 75%  |
| Commercial Paper                 | UK                                     | Counterparties including Banks and Corporates rated at least A- Long Term (or equivalent)                    | 15% / £20m                                      |
| Corporate Bonds                  | UK                                     | Counterparties including Banks and Corporates rated at least A- Long Term (or equivalent)                    | 15% / £20m                                      |

| <b>Instrument</b>               | <b>Country/<br/>Domicile</b> | <b>Counterparty</b>   | <b>Maximum<br/>Counterparty /<br/>Group Limit<br/>£m</b> | <b>Maximum<br/>Counterparty /<br/>Group Limit<br/>%</b> |
|---------------------------------|------------------------------|---|--|---|
| Term Deposits<br>/Call Accounts | UK                           | Lloyds Banking Group<br>(Including Bank of<br>Scotland)           | 20   | 15  |
| Term Deposits<br>/Call Accounts | UK                           | Barclays Bank Plc   | 20   | 15  |
| Term Deposits<br>/Call Accounts | UK                           | HSBC Bank Plc   | 20   | 15  |
| Term Deposits<br>/Call Accounts | UK                           | Nationwide Building<br>Society                                    | 20   | 15  |
| Term Deposits<br>/Call Accounts | UK                           | RBS Group (Royal Bank<br>of Scotland and Nat<br>West)             | 20   | 15  |
| Term Deposits<br>/Call Accounts | UK                           | Standard Chartered Bank   | 20   | 15  |
| Term Deposits<br>/Call Accounts | Australia                    | Australia and NZ Banking<br>Group                                 | 15   | 15  |
| Term Deposits<br>/Call Accounts | Australia                    | Commonwealth Bank of<br>Australia                                 | 15   | 15  |
| Term Deposits<br>/Call Accounts | Australia                    | National Australia Bank<br>Ltd (National Australia<br>Bank Group) | 15   | 15  |
| Term Deposits<br>/Call Accounts | Australia                    | Westpac Banking Corp  | 15   | 15  |
| Term Deposits<br>/Call Accounts | Canada                       | Bank of Montreal  | 15   | 15  |
| Term Deposits<br>/Call Accounts | Canada                       | Bank of Nova Scotia   | 15   | 15  |
| Term Deposits<br>/Call Accounts | Canada                       | Canadian Imperial Bank<br>of Commerce                             | 15   | 15  |
| Term Deposits<br>/Call Accounts | Canada                       | Royal Bank of Canada  | 15   | 15  |
| Term Deposits<br>/Call Accounts | Canada                       | Toronto-Dominion Bank   | 15   | 15  |
| Term Deposits<br>/Call Accounts | Finland                      | Nordea Bank Finland   | 15   | 15  |
| Term Deposits<br>/Call Accounts | France                       | BNP Paribas   | 15   | 15  |
| Term Deposits<br>/Call Accounts | France                       | Credit Agricole CIB<br>(Credit Agricole Group)                    | 15   | 15  |
| Term Deposits<br>/Call Accounts | France                       | Credit Agricole SA<br>(Credit Agricole Group)                     | 15   | 15  |

|                              |             |                            |    |    |
|------------------------------|-------------|----------------------------|----|----|
| Term Deposits /Call Accounts | France      | Société Générale           | 15 | 15 |
| Term Deposits /Call Accounts | Germany     | Deutsche Bank AG           | 15 | 15 |
| Term Deposits /Call Accounts | Netherlands | ING Bank NV                | 15 | 15 |
| Term Deposits /Call Accounts | Netherlands | Rabobank                   | 15 | 15 |
| Term Deposits /Call Accounts | Netherlands | Bank Nederlandse Gemeenten | 15 | 15 |
| Term Deposits /Call Accounts | Sweden      | Svenska Handelsbanken      | 15 | 15 |
| Term Deposits /Call Accounts | Switzerland | Credit Suisse              | 15 | 15 |
| Term Deposits /Call Accounts | US          | JP Morgan                  | 15 | 15 |

Note:

- The above list would change if a counterparty/country is upgraded, and meets our other creditworthiness tools or if a counterparty is downgraded.
- The above percentage limits are based on a 30 day rolling average investment balance.
- Non UK Banks are restricted to a maximum exposure of 25% per country and a total overseas aggregate exposure (excluding MMFs) of 40%.
- Maturity periods may be amended to less than one year to address any emerging risk concerns.

### Non Specified Investments determined for use by the Council

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

**Table 15**

|   | In-house use                        | Maximum maturity | Max % of portfolio    | Capital expenditure? |
|---|-------------------------------------|------------------|-----------------------|----------------------|
| <ul style="list-style-type: none"> <li>▪ Deposits with banks and building societies</li> <li>▪ CDs with banks and building societies</li> </ul> | ✓                                   | 5 Years          | 40<br>In Aggregate    | No                   |
| <ul style="list-style-type: none"> <li>▪ Gilts</li> <li>▪ Bonds issued by UK financial institutions</li> <li>▪ Corporate Bonds</li> </ul>       | ✓ (on advice from treasury advisor) | 6 Years          | 40<br>In<br>Aggregate | No                   |

In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

All Non Specified investments will satisfy the Council's "high credit quality" criterion. A maximum exposure limit of 75% has been set for Non Specified investments.