REVISIONS TO THE TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY 2013/14 TO 2015/16

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SUMMARY

Audit Committee considered the draft Annual Treasury Management Strategy Statement and Investment Strategy for 2013/14 to 2015/16 at the meeting on 7 January 2014. This was in advance of the final Statement being presented to Cabinet and Council in February 2013.

As part of the scrutiny process members requested that a further report should be brought to the March Audit Committee detailing the changes from the draft to the final version of the Statement.

RECOMMENDATIONS

That the contents of the report are noted.

INFORMATION

Amendments to the Annual Treasury Management Strategy Statement and Investment Strategy for 2013/14 to 2015/16

Since the draft TMSS was considered at Audit Committee in December a number of minor changes have been made to the final document to reflect updates to the Council's Capital Programme and to amend a few minor errors.

1. The forecast year-end cash balance at 31 March 2014 has increased by £10m from £96.4m to £106.4m as a result of a forecast increase in capital receipts for 2013/14. This change is reflected in paragraphs 1.2 and 5.7 and in Table 7.

2. The net borrowing requirement figures, detailed in Table 1, have reduced slightly as additional long term liabilities of £2.5m have now been included. As a result the amount by which the gross debt figure is below the CFR at 31 March 2014, included in paragraph 4.6, has changed from £78.8m to £76.3m.

3. Paragraph 4.12 quotes the Council's £49m variable rate borrowing. The rate on this borrowing is now 0.57%, previously 0.65%.

4. As a result of changes to the Capital programme (documented in the Budget Report to Cabinet in February) the Authorised Limit and the Operational Boundary, detailed in tables 2 and 3, have been updated. In addition the prudential indicators in Appendix B have all been refreshed following these programme changes.

5. A change was omitted from the draft strategy which has now been rectified in the final version, namely that the maximum limit of cash holdings which can be placed with Money Market Funds has decreased from 75% to 50%. This change is reflected in paragraph 5.5 and in table 13 in appendix D.

6. Table 6 - upper limit for 2014/15 has been reduced from £80m to £73m as a result of the increase in capital receipts.

7. A presentational change in Table 10 to show the split between GF and HRA borrowing has now been included.

8. In Section v of Appendix D - HRA indebtedness - the HRA potential headroom has reduced from £64m to £53.7m. This was a drafting error.

9. Appendix C has now been replaced with the latest available information.

10. Table 14 has been amended to be consistent with the narrative in the report, to clarify that only loans to other local authorities can exceed 1 year in length.

A copy of the final version of the report is attached at Appendix A.

Appendix A

TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2014/15 TO 2016/17

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 2014 the Council's loan portfolio is expected to be £336.2m and the total value of investments are forecast to be £106.4m.

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 2014 is £415m, of which £176m is attributed to the General Fund (GF) with the remaining £239m within the Housing Revenue Account (HRA).

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 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.

1.6 The security of any investment remains the primary consideration in decision making and a cautious approach is always adopted. Officers regularly monitor all institutions on the counterparty list and a cautious approach will be maintained in determining counterparties, maximum investment and length of investment.

1.7 The investment strategy has been simplified this year and only those institutions and financial instruments which the Council has the intention of using have been included. Additionally, consideration has been given to the implications of the Financial Services (Banking Reform) Bill, currently progressing through the House of Lords, particularly the ‘bail-in’ mechanism, which could come into effect from early 2014, and which could increase the potential for partial loss of deposits in UK Banks, in the case of banks making losses. (This measure has been introduced to prevent the taxpayers having to bail out large banks in the future.) As a result, to further diversify risk the Council has reduced the individual counterparty holding limit from 15% to 10% and has increased its portfolio of counterparties to include Santander UK, Close Brothers and Leeds Building Society, all UK institutions recommended by Arlingclose. Similar legislation is being enacted across the EU which will impact on European banks.

1. Background

1.1. 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.

1.2. 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.

1.3. The purpose of this TMSS is to facilitate Council to approve:
- Treasury Management Strategy for 2014/15
- Annual Investment Strategy 2014/15
- Prudential Indicators for 2014/15, 2015/16 and 2016/17
- MRP Statement

1.4. These strategies are formulated in conjunction with the Council’s Medium Term Financial Forecast (MTFF) and are reflected in 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.

1.5. 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.

1.6. The average rate of interest paid on Council borrowing for 2013/14 is expected to be 3.00%, however, rates on investments are also very low with an expected average rate of 0.48%. Rates are projected to be similar for 2014/15.

2. Balance Sheet and Treasury Position

2.1. 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. The increasing General Fund CFR is due to the Council's programme of capital investment, particularly the schools capital programme, while the reducing HRA CFR is as a result of repayment of debt transferred from central government.

Table 1

Table 1	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
General Fund CFR	176.0	208.8	243.4	296.3
HRA CFR 1	239.0	231.7	224.4	217.1
Total CFR	415.0	440.5	467.8	513.4
Existing Profile of Borrowing and Other Long Term Liabilities 2	(338.7)	(329.2)	(316.4)	(309.1)
Cumulative Maximum External Borrowing Requirement	**76.3**	**111.3**	**151.4**	**204.3**
Usable Reserves 3	(56.0)	(56.0)	(51.0)	(51.0)
Cumulative Net Borrowing Requirement	**20.3**	**55.3**	**100.4**	**153.3**

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 totaling £11m, £13m and £14m respectively will be in a state of call. Other long term liabilities include commitments under finance leases and a private finance initiative (PFI).
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.

2.2. 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.

2.3. 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.

3. Borrowing and Rescheduling Strategy

3.1. The Council's external debt at 31 March 2014 (gross borrowing plus other long term liabilities) will be £338.7m (Appendix A). This is currently considerably lower than both the Operational Boundary and Authorised Limit (explained below).

3.2. During 2013/14, £10.3m of borrowing was repaid through scheduled installments and maturities with £6.8m attributable to the GF and £3.5m to the HRA. In 2014/15 repayments of £9.3m will be made, with £3.8m attributable to the GF and £5.5m to the HRA.

3.3. 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

Authorised Limit for External Debt	**2013/14 Approved £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Borrowing	515	543	543	533
Other Long term Liabilities	2	2	2	2
Authorised Limit	**517**	**545**	**545**	**535**

3.4. 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

Operational Boundary for External Debt	2013/14 Approved £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	485	513	513	503
Other Long term Liabilities	2	2	2	2
Operational Boundary	**487**	**515**	**515**	**505**

3.5. The Corporate 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.

3.6. The **Gross Debt compared to the Capital Financing Requirement** 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 £76.3m below the CFR as at March 2014.

3.7. The Corporate Director of Finance will report that the Council has had no difficulty meeting this requirement in 2013/14, nor are there any difficulties envisaged for future years.

3.8. **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

3.9. In 2013 the Council successfully renewed its ability to avail itself of the preferential PWLB "Certainty Rate", which is a 0.2% reduction against normal PWLB lending rates. Although a mix of borrowing options will always be considered, the PWLB will remain the primary source of long-term and variable rate borrowing whilst rates remain closely linked to government gilts.

3.10. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing
- Medium-term Equal Installments of Principal (EIP) or Annuity Loans
- Long term Maturity loans, where affordable

3.11. 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 2014/15. 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 will again be the most cost effective means of financing capital expenditure.

3.12. 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 £49m (of which £40m is HRA) at a rate of 0.57%.

3.13. The Council has £48m of LOBO loans (Lender's Option Borrower's Option) of which £11m will be in their call period in 2014/15. 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. The Council does not intend to utilise LOBOs as an instrument for new borrowing in 2014/15.

3.14. In 2014/15 there is a difference of £56m 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'.

3.15. **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 to identify opportunities for rescheduling. 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.

3.16. Transfers of debt between the GF and HRA will be undertaken at a zero premium. The debt specified for transfer will be based on a “last in, first out” basis and matched to optimise maturity profiles and financing costs.

3.17. 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.

3.18. 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 31/03/14 %**	**2013/14 Approved %**	**2014/15 Estimate %**	**2015/16 Estimate %**	**2016/17 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.

3.19. The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. The 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 31/03/14 %	Market LOBO 1st call option at 31/03/14 %	Lower Limit for 2014/15 %	Upper Limit for 2014/15 %
under 12 months	2.71	3.83	0	25
12 months and within 24 months	3.75	4.53	0	25
24 months and within 5 years	7.50	6.61	0	50
5 years and within 10 years	21.74	1.74	0	100
10 years and within 20 years	18.80	0.00	0	100
20 years and within 30 years	20.57	0.00	0	100
30 years and within 40 years	8.22	0.00	0	100
40 years and within 50 years	0.00	0.00	0	100
50 years and above	0.00	0.00	0	100
Total	**83.29**	**16.71**	**0**	**100**

4. Annual Investment Strategy

4.1. In accordance with Investment Guidance from DCLG and best practice, the Council's primary objectives 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.

4.2. Investments are categorised as 'Specified' or 'Non Specified', defined in Appendix D, and based on the criteria set out by the DCLG. Appendix D contains a list of the financial instruments and institutions which the Council may use within its investment strategy. The Corporate 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, with reference to the Prudential Indicators and from the list detailed in Appendix D. Decisions concerning the core strategic investment portfolio will be reported monthly to Cabinet.

4.3. In developing the investment strategy, note is taken of current economic conditions. Growth within the UK economy is forecast to remain on a positive track through 2014/15. Other indicators including unemployment and inflation are also encouraging and are expected to contribute positively towards a stronger economy. On the regulatory front, the Financial Services (Banking Reform) Bill will introduce a "bail in" mechanism, which could mean that local authorities and other large depositors (wholesale depositors) could be exposed to losses, increasing the counterparty risk. In addition there are EU proposals under which all money market funds may move to variable net asset value and lose their AAA credit rating wrapper. However, this has not yet been agreed and will be closely monitored.

4.4. Following a review of investment counterparties and to reduce the concentration of risk, Santander UK, Close Brothers and Leeds Building Society have been added to the list eligible counterparties. In addition, to ensure a further spread of credit risk, individual counterparty limits have been reduced from 15% to 10%.

4.5. Money Market Funds remain an important vehicle for instant access deposits. The criteria of constant net asset value and AAA rating have been removed in order they may still be utilised should EU proposals be introduced. In making these changes the primary objectives of security and liquidity will prevail and credit risk assessment techniques will operate. In addition the total MMF exposure limit has been reduced from 75% to 50%.

4.6. Instruments and counterparties which will not be used have been removed from the counterparty list and these include overseas and multilateral development banks, corporate bonds (excluding listed UK Banks) and commercial paper.

4.7. The Council's estimated level of investments at 31 March 2014 is projected to be £106.4m (Appendix A).

4.8. 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.

4.9. Investment returns attributable to the HRA will be credited to the HRA and calculated in accordance to the DCLG's Item 8 determination.

4.10. **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.

Where a credit rating agency announces that an A- rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criterion, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.11. The UK Bank Rate has been at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2014/15. 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.

4.12. With short term interest rates forecast to be low for even longer, the 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. This will typically be achieved through deposits with local authority entities for durations in excess of one year

4.13. 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. The maximum investment level with each counterparty will be set to ensure prudent diversification is achieved and this is reviewed regularly.

4.14. 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.

4.15. **Liquidity Management:** The Council uses cash flow modelling techniques to determine the maximum term for which funds may be prudently committed. Liability matching in conjunction with the use of instant access accounts ensures funds are available when required. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

4.16. **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.

4.17. **The use of financial instruments for the management of risk:** The general power of competence in section 1 of the Localism Act 2011 removes much of the uncertainty over the use of standalone financial derivatives. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks to which the Council is exposed. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

4.18. 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.

4.19. 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 under Council's strategy only investments placed with other local authorities, where risk is minimised, would be placed for over 1 year and there is an upper limit of 2 years.

Table 6

Upper Limit for total principal sums invested over 364 days	2013/14 Approved £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
	64	73	45	0

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

5. Outlook for Interest Rates

5.1. 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.

6. Balanced Budget Requirement

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

7. Adoption of the CIPFA Treasury Management Code:

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

8. 2014/15 MRP Statement

8.1. 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.

8.2. 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.

8.3. MRP in 2014/15: Option 1 and 2 will be used for the majority of GF historic debt. 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. 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.

9. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

9.1. 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.

9.2. 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 January. Any amendments to the TMSS which are required during the year will be submitted to Cabinet for approval.

10. Other Items

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

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

APPENDIX A

EXISTING PORTFOLIO PROJECTION

Table 7

	Estimated Portfolio as at 31/03/14 £m
External Borrowing:	
Fixed Rate – PWLB	239.2
Fixed Rate – Market	37.0
Variable Rate – PWLB	49.0
Variable Rate – Market	11.0
Total External Borrowing	336.2
Other Long Term Liabilities:	
PFI	2.2
Finance Leases	0.3
Total Gross External Debt	338.7
Investments:	
Short-term & Instant Access	106.4
Long-term Investments	0.00
Total Investments	106.4

APPENDIX 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	**2013/14 Approved £m**	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
General Fund	91.6	87.3	119.8	96.7	122.2
HRA	26.0	0.0	23.1	24.0	24.7
Total	**117.6**	**87.3**	**142.9**	**120.7**	**146.9**

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

Table 9

Capital Financing	**2013/14 Approved £m**	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Capital Receipts	10.0	11.4	17.1	15.4	6.0
Government Grants	35.8	50.4	51.7	37.6	55.8
Major Repairs Allowance	8.3	0.0	9.0	9.0	9.0
Revenue Contributions	3.5	7.4	27.6	19.3	18.4
Total Financing	**57.6**	**69.2**	**105.4**	**81.3**	**89.2**
Prudential Borrowing	60.0	18.1	37.5	39.4	57.6
Total Funding	60.0	18.1	37.5	39.4	57.6
Total	**117.6**	**87.3**	**142.9**	**120.7**	**146.8**

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

Actual External Debt as at 31/03/2014	£m
General Fund Borrowing	86.6
HRA Borrowing	249.6
Other Long term Liabilities	2.5
Total	**338.7**

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 £53.7m to finance future capital as at 31 March 2014.

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. Council Tax will remain frozen for 2014/15 and 2015/16, with an element of continuing efficiency savings being reinvested in capital investment to maintain and expand existing services to Residents.

Table 11

Incremental Impact of Capital Investment Decisions	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Increase in Band D Council Tax	£6.70	£14.91	£14.61
Increase in Average Weekly Housing Rents	£0.41	£0.17	£0.08

vii. 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

Ratio of Financing Costs to Net Revenue Stream	2013/14 Revised %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
General Fund	4.24	4.57	5.42	6.26
HRA	23.93	23.99	23.39	22.78
Weighted Average	**8.76**	**8.99**	**9.68**	**10.31**

APPENDIX C

Arlingclose's Economic and Interest Rate Forecast

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.50	0.50	0.75	0.75	0.75	1.00	1.00	1.00
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**
Downside risk										0.25	0.25	0.50	0.50
3-month LIBID rate													
Upside risk	0.20	0.25	0.30	0.35	0.40	0.50	0.75	0.75	0.75	1.00	1.00	1.00	1.10
Arlingclose Central Case	**0.45**	**0.45**	**0.50**	**0.55**	**0.65**	**0.70**	**0.75**	**0.80**	**0.90**	**1.00**	**1.10**	**1.20**	**1.25**
Downside risk			0.05	0.10	0.20	0.25	0.30	0.35	0.45	0.55	-0.65	-0.75	-0.80
1-yr LIBID rate													
Upside risk	0.35	0.30	0.35	0.40	0.45	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.80
Arlingclose Central Case	**0.90**	**0.95**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**1.20**	**1.30**	**1.40**	**1.50**	**1.60**	**1.70**
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt yield													
Upside risk	0.20	0.30	0.40	0.50	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.20
Arlingclose Central Case	**1.70**	**1.75**	**1.85**	**1.95**	**2.00**	**2.00**	**2.05**	**2.10**	**2.20**	**2.35**	**2.50**	**2.65**	**2.80**
Downside risk	-0.20	-0.20	-0.30	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.75	-0.80	-0.90	-1.00
10-yr gilt yield													
Upside risk	0.20	0.35	0.45	0.50	0.60	0.70	0.75	0.80	0.90	0.90	0.95	1.00	1.00
Arlingclose Central Case	**2.75**	**2.80**	**2.90**	**2.95**	**3.00**	**3.10**	**3.20**	**3.30**	**3.40**	**3.50**	**3.60**	**3.70**	**3.80**
Downside risk	-0.20	-0.30	-0.40	-0.50	-0.55	-0.60	-0.70	-0.80	-0.90	-0.95	-1.00	-1.05	-1.05
20-yr gilt yield													
Upside risk	0.30	0.40	0.50	0.60	0.75	0.85	0.90	0.95	1.00	1.05	1.05	1.05	1.05
Arlingclose Central Case	**3.35**	**3.40**	**3.45**	**3.55**	**3.60**	**3.60**	**3.65**	**3.70**	**3.75**	**3.80**	**3.85**	**3.90**	**3.95**
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80
50-yr gilt yield													
Upside risk	0.30	0.40	0.50	0.60	0.75	0.85	0.90	0.95	1.00	1.05	1.05	1.05	1.05
Arlingclose Central Case	**3.45**	**3.50**	**3.55**	**3.60**	**3.65**	**3.70**	**3.75**	**3.80**	**3.85**	**3.95**	**4.00**	**4.05**	**4.10**
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80

Underlying assumptions:

- UK economic growth has steadily strengthened, although GDP remains around 1.3% below the pre-recession peak. The initial estimate showed that Q4 year-on-year GDP growth strengthened to 2.8% from the previous quarter's 1.9% rate. The service sector remains the main driver of growth.
- Expenditure breakdown of the GDP data during 2013 (Q4 details are awaited) indicates that the recovery has been led by consumer spending and housing investment. Given negative real earnings growth and the waning impact of temporary income boosts from bank mis-selling compensation, household spending growth at current rates appears unsustainable in the short to medium term. An expansion in business investment and rebalancing of the economy will be necessary for sustained growth.
- An expected slowdown in household spending growth should keep inflation contained. The CPI rate for December 2013 fell to the MPC's target of 2.0% and we expect it to

remain around this level for some time. Inflation expectations are well anchored and commodity price volatility is subdued.

- The recovery has not been accompanied by meaningful productivity growth. Business investment is expected to pick up in the medium term and should help to restore productivity growth, leading to higher wages and more sustainable growth in consumption. We expect this to have a material impact on growth from 2016. In the short term, however, on-going regulatory reform and a focus on balance sheet restructuring is likely to prolong banking sector deleveraging and maintain the corporate credit bottleneck, which will dampen business investment.
- The unemployment rate has fallen close to the 7% forward guidance threshold earlier than expected, although this number is flattered by the large numbers of people involuntarily underemployed. The MPC has made clear that 7% is not a policy trigger and we expect no response if surpassed in the short term. Additionally, any likely monetary tightening response is likely to be applied "gradually".
- Political risk for the UK will begin to influence gilt yields closer to the General Election in May 2015.
- Federal Reserve monetary policy expectations will remain predominant drivers of the financial markets. Tapering of asset purchases has begun and is expected to continue at a broadly steady rate in 2014. Additionally, the US political deadlock over the debt ceiling will need resolving in Q1 2014. This may prompt temporary volatility.
- The economic environment in the Eurozone is slightly more stable but structural issues persist and credit conditions remain challenging for European banks.
- There is a risk China will suffer from a credit crunch style crisis, as the authorities seek to stem lending growth. This has possible negative repercussions for domestic retail investors and the highly leveraged local government sector, which could dampen domestic spending and investment.

Forecast

- We are now forecasting the first rise in official interest rates in Q2 2016 but our long held theme of low for even longer remains. There is clear momentum in the economy although some weakness remains in some components of growth. Unemployment has fallen much faster than expected but has not led to any wage growth and productivity remains stagnant. We see both these indicators alongside business investment remaining the key to modestly higher interest rates. Inflation has fallen faster than expected and currently sits at target. The gradual recovery in the economy is underway. Whilst further challenges to that momentum cannot be ruled out, some upside potential for official interest rates must be ruled-in.
- We continue to project gilt yields on an upward path through the medium term as the recovery gradually takes hold.

APPENDIX D

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 all Non Specified investments will satisfy the Council’s “high credit quality” criterion except money market funds where a weighted average of the underlying assets will be applied.

The Council defines “high credit quality” organisations as those having a credit rating of A- or higher that are domiciled in the UK.

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 UK banks and building societies
- Certificates of deposit and Bonds with UK banks and building societies
- Gilts: (bonds issued by the UK government)
- Treasury Bills (T-Bills)
- Local Authority Bonds
- Money Market Funds

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). The Council will aim to have a weighted average credit score of A for the whole portfolio of investments.

Specified investments will be made within the following limits:

Table 13

Instrument	**Counterparty**	**Maximum Counterparty Limits %/£m**
Term Deposits	DMADF, DMO	No limit
Term Deposits	Other UK Local Authorities	£35m per Local Authority / No total limit
Term Deposits/Call Accounts/CD's/Bonds	UK Banks and Building Societies - Lloyds Banking Group (Including Bank of Scotland) - Barclays Bank Plc - Close Brothers - HSBC Bank Plc - Leeds Building Society - Nationwide Building Society - RBS Group (Royal Bank of Scotland and NatWest) - Santander UK - Standard Chartered Bank	10% / £20m (except Leeds Building Society £1m)
Gilts	DMO	No limit
Treasury Bills	DMO	No limit
Local Authority Bills	Other UK Local Authorities	No limit
Money Market Funds	Money Market Funds	10%/£7.5m per fund. Maximum MMF exposure 50%

Note: The above list and limits would change/be amended on notification of any potential 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 2

	Maximum maturity	**Max % of portfolio**
▪ Deposits and Bonds with other UK Local Authorities	2 Years	40 in Aggregate
▪ Money Market Funds	N/A	

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 except money market funds where a weighted average of the underlying assets will be applied.
A maximum exposure limit of 40% has been set for Non Specified in