12 February 2014	ITEM: 12 01104269
Cabinet	
Borrowing And Investment Annual Strategy And The Annual Minimum Revenue Provision Statement 2014/15	
Portfolio Holder: Councillor John Kent, Portfolio Holder for Finance and Strategy	
Wards and communities affected: All	**Key Decision:** Yes
Accountable Head of Service: Sean Clark, Head of Corporate Finance	
Accountable Director: Graham Farrant, Chief Executive	
This report is Public	
Purpose of Report: To recommend the Treasury Management Strategy for 2014/15, including the Prudential Indicators, to Council.	

EXECUTIVE SUMMARY

The CIPFA Code of Practice for Treasury Management in Public Services and the Prudential Code requires local authorities to determine the Treasury Management Strategy and Prudential Indicators on an annual basis. The annual strategy also includes the Annual Investment Strategy that is a requirement of the Department for Communities and Local Government Investment Guidance.

In accordance with the above Codes, this report:

a) makes proposals for the Prudential Indicators for 2014/15;

b) reviews borrowing and investment strategies for 2014/15; and

c) sets out a draft Treasury Management budget for 2014/15.

The borrowing limits are determined for statutory purposes and to maximise flexibility. They do not mean that the Council will necessarily borrow up to the amounts specified.

1 RECOMMENDATIONS:

1.1 That Cabinet recommend that the Council:

a) Agree the Prudential Indicators as set out in Appendix 1;

b) Delegate any changes to the Prudential Indicators to Cabinet where changes are required due to the delivery mechanism for affordable homes in the borough as outlined in paragraph 2.16;

c) Agree the Annual Borrowing and Investment Strategy starting from paragraph 2.32;

d) To approve the Annual Borrowing and Investment Strategy and the Annual Minimum Revenue Provision (MRP) Statement for 2014/15 as follows;

- **For debt where the government provides revenue support the Council will set aside 4% of the notional debt relating to capital investment, but excluding capital investment on the HRA housing stock (known as the non-HRA capital financing requirement;**

- **For debt where the government provides no revenue support: - where the debt relates to an asset the Council will set aside a sum equivalent to repaying debt over the life of the asset in equal instalments, or where the debt relates to expenditure which is subject to a capitalisation direction issued by the government, the Council will set aside a sum equivalent to repaying debt over a period consistent with the nature of the expenditure except where the Head of Corporate Finance believes that the expenditure will result in a capital receipt that will repay the debt at some point in the future; and**

e) To note the revised 2013/14 and 2014/15 borrowing and investment projections as set out in the report (paragraph 2.36).

2 INTRODUCTION AND BACKGROUND:

2.1 This Borrowing and Investment Annual Strategy and Annual MRP Statement is prepared under the terms of the CIPFA Prudential Code for Capital Finance in Local Authorities (the code) and seeks approval for the Prudential Indicators in accordance with the Code. CIPFA revised the Treasury Management Code and Guidance Notes as well as the Prudential Indicators in late 2011. The Council has had regard to all these documents in compiling this report.

2.2 The report also revises the 2013/14 forecast for interest on borrowing and investment and forecasts the 2014/15 indicative interest payable and receivable.

Borrowing Activity 2013/14 and 2014/15

2.3 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with balances and reserves, are the core drivers of Treasury Management activity. The estimates, based on the current revenue budget and capital programmes are:

	31/3/2014 Estimate £m	**31/3/2015 Estimate £m**	**31/3/2016 Estimate £m**
General Fund Borrowing CFR	127,391	146,335	153,978
HRA Borrowing CFR (includes effects of Housing Finance Reform based on current available figures)	166,021	186,566	189,665
Total Borrowing CFR	**293,412**	**332,901**	**343,643**
Less: External Borrowing	283,889	283,889	283,889
Internal/(Over) Borrowing	**9,523**	**49,012**	**59,754**
Less: Usable Reserves	15,000	10,000	8,000
Borrowing Requirement	**-5,477**	**39,012**	**51,754**

2.4 The Council’s level of physical debt and investments is linked to these components of the balance sheet. The Council’s chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council’s long term plans change is a secondary objective.

2.5 Given the significant cuts to public expenditure and in particular to local government funding, the Council’s borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short term interest rates currently much lower than long term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

2.6 By doing so, the Council is able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 1-2 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise. The Council's advisors, Arlingclose, will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long term fixed rates in 2014/15 with a view to keeping future interest costs low, even if this causes additional cost in the short term.

2.7 In addition, the Council may borrow short term loans (normally up to one month) to cover unexpected cash flow shortages.

2.8 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the following sources for long term and short term borrowing:

- PWLB loans;
- UK Local Authorities;
- Any institution approved for investments;
- Any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK;
- UK public and private sector pension funds;
- Capital market bond investors;
- Special purpose companies created to enable joint local authority bond issues;
- Local Authority bills;
- Structured finance;

2.9 The Council has £29 million of loans which are LOBO loans (Lenders Option Borrowers Option) where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these loans are now in their call period and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. In the event the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan by borrowing from the PWLB or capital markets.

2.10 With regards to debt rescheduling, the PWLB allows Councils to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature repayment terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

2.11 Borrowing and rescheduling activity will be reported to both the Standards and Audit Committee and Cabinet on a regular basis during 2014/15.

2.12 In August 2010 the Council repaid its entire PWLB portfolio of loans (£84 million) to obtain significant interest savings. The re-financing was undertaken by utilising short term funds from the money markets, mainly other Local Authorities, at substantially lower rates than taking longer term fixed debt. It is envisaged that with the current outlook for interest rates that financing from short term money market debt will continue in 2014/15 and probably beyond. It is recognised that this policy does present on-going risk with regard to potentially higher rates and increased debt costs in the future.

2.13 However, this was weighed against the reality of holding fixed rate debt, at a substantial margin above short term rates, for what could prove to be a prolonged period. Borrowing can be swiftly re-fixed if required via the PWLB, either in total within a matter of days of the decision to re-fix being made or profiled against the maturity schedule of the short term debt. While it is inevitable that interest rates will eventually rise and inflation remains above target, it is the current assessment that official rate increases will not occur until around March 2017. Officers and the Council's advisors will continue to closely monitor the situation to ensure any action is taken as and when required.

2.14 Based on this outlook, officers are working on a plan for a phased move away from temporary debt from April 2015 and the increased costs have been included within the Medium Term Financial Strategy (MTFS) to reflect this.

2.15 On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. The Council will credit interest to the HRA based on the average balances of its reserves and revenue account balance at the average 7 day LIBID rate for the year.

2.16 The Council has made clear an aspiration to create new affordable homes in the borough. The delivery body of these homes is to be a wholly owned company (Gloriana) with the Council borrowing the required funding and lending it on to the company at an enhanced rate to meet State Aid requirements. This in all likelihood will entail in year changes to the Council's prudential indicators and it is requested that changes to the prudential indicators be delegated to Cabinet for this purpose only to allow the development to take place. The changes would be required in terms of the Council's borrowing activity with a likely increase over the period of development.

2.17 In addition to the provision of new Council housing outlined in paragraph 2.16, the Council is also undertaking a series of new building schemes utilising borrowing headroom within the HRA debt cap. Current indications are for new borrowing of approximately £25.0m over the next three years that would put the Council's HRA borrowing level close to its debt cap. The Council will therefore manage this programme to keep the HRA borrowing level within the

Debt Cap by utilising other resources for example capital receipts from Council house sales or other cash backed resources.

Investments

2.18 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months the Council's investment balances have ranged between £40 million at peak times to £15 million at the year end and similar levels are expected to be maintained in the forthcoming year. The Council may invest its surplus funds with any of the counterparties detailed in Appendix 2.

2.19 Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield. The Authorities objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

2.20 The Council uses long term credit ratings from the three main rating agencies, Fitch Ratings, Moody's Investor Services and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment specific rating is available. Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made;
- Any existing investments that can be recalled or sold at no cost will be; and
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

2.21 Where a credit rating agency announces that an A- rating is on review for possible downgrade (known as 'rating watch negative' or 'credit watch negative') so that it may fall below the approved rating criteria, 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.

2.22 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regards will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may reach the credit rating criteria.

2.23 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office for example or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum involved.

2.24 The Council continues to use Investec as Fund Managers with £15 million in Investec's Segregated Fund and £5 million in Investec's Target Return and Short Dated Bond Fund (previously called the Cash Plus Fund).

2.25 Local Authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over Authorities use of standalone financial derivatives. The CIPFA code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

2.26 The Authority will only use standalone derivatives (such as swaps, forward, futures and options) where they can be clearly demonstrated to reduce the overall level of financial risks that the Authority is exposed to. 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.

2.27 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. The local authority will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

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

2.29 The needs of the Council's treasury management staff for training in investment management are assessed as part of the annual staff appraisal process and additionally where the responsibilities of individual members of staff change. Staff regularly attend courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study for professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

2.30 The Council has appointed Arlingclose Ltd as treasury management advisers and receives specific advice on investments, debt and capital finance issues. The quality of service is controlled by regular review meetings between Arlingclose Ltd and officers from the Council.

2.31 The Authority may, from time to time, borrow in advance of need where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums and the risk that investment and borrowing rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks. The total amount borrowed by the Council will not exceed the Council's Authorised Borrowing Limit as set in the prudential indicators. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure. Any potential situation will be assessed for suitability as to the overall effect on the Council's treasury position.

Annual Borrowing and Investment Strategy and Annual MRP Statement

2.32 Local Authorities are required to prepare an Annual Statement of their policy on making MRP for each financial year.

2.33 Officers have reviewed the current strategy and recommend that the only revision to the strategy for 2014/15 is acknowledging that MRP will not be provided on prudential borrowing where the Head of Corporate Finance's judgement is that there will be a capital receipt arising from the scheme that will repay the debt. An example of this is the approach to managing the debt with Gloriana.

2.34 Therefore, with regards to the foregoing paragraphs on Borrowing Activity and Investments the following statement forms the Council's Borrowing and Investment Strategy with effect from 1 April 2014:

a) To obtain any long term borrowing requirement from the sources of finance mentioned in paragraph 2.8;

b) To continue to fund the ex-PWLB debt via short term funds from the money markets unless circumstances dictate moving back into long term fixed rate debt. The borrowing sources mentioned in paragraph 2.8 will then be assessed as to their suitability for use.

c) Repay market loans that come up for renewal by realising equivalent amounts of investments. If it is not possible to realise investments then the borrowing sources in paragraph 2.8 will be assessed as to their suitability for use as replacements.

d) To undertake short term temporary borrowing when necessary in order to manage cash flow to the Council's advantage.

e) Reschedule market and PWLB loans, if practicable, to achieve interest rate reductions, balance the volatility profile or amend the debt profile, dependent on the level of premiums payable or discounts receivable.

f) Ensure security and liquidity of the Council's investments and to then optimise investment returns commensurate to those ideals.

g) Contain the type, size and duration of investments with individual institutions within the limits specified in Appendix 2.

h) Move a further £5 million into Investec's Short Dated Bond Fund and Target return Fund if it is felt prudent to do so;

i) In accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2014/15 shall be the regulatory method for supported borrowing and the asset life (equal instalment) method for Prudential borrowing except where the scheme will generate a capital receipt to redeem the debt.

Interest Projections 2013/14 Revised and 2014/15 Original

2.35 The CIPFA document Treasury Management in the Public Services: Code of Practice places a requirement on Council to publish estimates relating to the operation of the borrowing and investment function.

2.36 The 2013/14 budget and the final projected position for 2013/14 and also an initial projection for 2014/15 are shown in summary format in table 2 below: -

		Budget 2013/14 £000's	Projected 2013/14 £000's	Original 2014/15 £000's
	Expenditure			
	Interest payable on External Debt			
1.	Debt Interest	2,935.0	2,435.2	2,428.4
2.	Total interest payable	-106.9	109.0	109.0
3.	Net Interest charged to General Fund	2,828.1	2,544.2	2,537.4
	Income			
4.	Interest on Investments	-454.0	-167.00	-232.7
5.	Net interest charged to General Fund	2,374.1	2,377.2	2,304.7
6.	MRP- Unsupported Borrowing	2,749.1	2,749.1	3,685.6
7.	MRP- Supported Borrowing	4,056.6	4,056.6	3,875.7
8.	Treasury Management expenses	150.0	150.0	150.0

2.37 It should also be noted that the figures shown above for 2014/15 are based on assumptions made about the level of balances available for investment, any anticipated new long term borrowing and the level of interest rates achievable. They are therefore liable to be subject to a significant degree of change during the year arising from variations in interest rates and other market and economic developments, and officers' response to those events.

2.38 In accordance with the requirements of the revised CIPFA Treasury Management Code, the Council will report on treasury management activity and the outturn against the treasury related Prudential Indicators at least twice a year, one such report will be after the financial year end.

3 ISSUES, OPTIONS AND ANALYSIS OF OPTIONS:

3.1 There is very little in terms of options as the policies are largely set out by guidance and legislation and prudential indicators are governed by decisions around the revenue and capital budgets.

3.2 There are two key areas in this report for Members to be particularly mindful of:

a) The plan to maintain temporary borrowing for the next financial year and implement a plan of a phased move away from temporary debt from 2015/16. Officers will continue to monitor this to react to any changes in the economy; and

b) There is a clear commitment and need for affordable housing in the borough and this could impact on the prudential indicators appended to this report through an increase in borrowing.

4 REASONS FOR RECOMMENDATION:

4.1 There is a legal requirement for a Borrowing and Investment Annual Strategy and the Annual Minimum Revenue Provision Statement. This report and appendices has been written in line with best practice and the Council's spending plans.

5 CONSULTATION

5.1 The Council's Treasury Advisors, Arlingclose, have been consulted. As set out in section 4, the report is largely based on best practice and the Council's spending plans that have been scrutinised throughout recent months.

6 IMPACT ON CORPORATE POLICIES, PRIORITIES, PERFORMANCE AND COMMUNITY IMPACT

6.1 Treasury Management plays a significant support role in the delivery of services to the community. Since the debt restructure in August 2010, the function has contributed in excess of £10m to reserves and services.

7 IMPLICATIONS

7.1 Financial

Implications verified by: **Chris Buckley**
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The financial implications are included in the main body of the report.

7.2 **Legal**

Implications verified by: **David Lawson**
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dlawson@thurrock.gov.uk

The report is in accordance with the Local Government Act 2003, related secondary legislation and other requirements including the Prudential Code.

Publication of the strategies is a statutory requirement and conforms to best practice as required by the CIPFA Code of Practice.

7.3 **Diversity and Equality**

Implications verified by: **Samson DeAlyn**
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There are no direct diversity implications noted in this report

7.4 **Other implications (where significant) – i.e. Section 17, Risk Assessment, Health Impact Assessment, Sustainability, IT, Environmental**

Not applicable.

8 CONCLUSION

8.1 The report sets out the Annual Borrowing and Investment Strategy and the Annual Minimum Revenue Provision Statement. The function has again contributed towards protecting front line services and will be used to facilitate the housing development programme for the borough.

BACKGROUND PAPERS USED IN PREPARING THIS REPORT:

- Revised CIPFA Prudential Code
- Revised draft ODPM's Guidance on Local Government Investments
- Revised CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes
- Treasury Management Policy Statement
- 2013/14 Annual Investment Strategy
- Arlingclose's Investment Review.

APPENDICES TO THIS REPORT:

- Appendix 1 – Prudential Indicators
- Appendix 2 – Specified and Non-Specified Investments
- Appendix 3 – MRP

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APPENDIX 1

PRUDENTIAL INDICATORS 2014/15 TO 2016/17

The following prudential indicators are recommended to the Council.

A. Prudential indicators for Affordability

In demonstrating the affordability of its capital investment plan the council must:

- Determine the ratio of financing costs (e.g. capital repayments, interest payments, investment income, etc) to net revenue stream for both the Housing Revenue Account (HRA) and non-HRA services for a 3 year period.

- Determine the incremental impact on the council tax and housing rents (in both instances the scope for increases is governed by the Government's ability to limit council tax increases and the current restriction on council rents).

Indicator A1 sets out the ratio of financing costs to net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.

A1: Prudential indicator – Estimates of the ratio of financing costs to net revenue stream 2014/15 to 2016/17

Indicator	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Non HRA	8.3%	12.0%	15.0%
HRA	39.8%	38.6%	37.2%

Indicators A2 and A3 set out the estimated incremental impact on both the levels of council tax (Band D equivalent) and housing rents of the recommended capital investment plans and funding proposals. The impact has been calculated using the latest projections on interest rates for both borrowing and investments. The impact does not take account of government support included for new borrowing within the formula spending share and housing subsidy.

A2: Prudential indicator – Estimates of the incremental impact of the new capital investment decisions on the council tax 2014/15 to 2016/17

Indicator	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Additional annual Council Tax requirement	£1.45	£26.54	£42.88

A3: Prudential indicator – Estimates of the incremental impact of the new capital investment decisions on the average weekly housing rents 2014/15 to 2016/17

Indicator	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Addition in average weekly housing rent	£5.42	£12.02	£13.87

B. Prudential indicators for Prudence

B1: Prudential indicator – Gross debt and the capital financing requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt.

The Director of Finance and Corporate Governance reports that the Authority had no difficulty meeting this requirement in 2013/14, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Where the gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy

C. Prudential indicator for Capital Expenditure

Elsewhere in this report is a recommendation for the capital investment plans for the Council over the next three years. Indicator C1 summarises the recommendations within that report. Indicator C2 sets out the estimates of the capital financing requirement over the same period.

C1: Prudential indicator – Estimates of total capital expenditure 2014/15 to 2016/17

Indicator	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Total Non HRA	49,031	25,301	20,832
Total HRA	37,837	12,850	12,850
Total Programme	86,868	38,151	33,682

In considering the capital investment plan the Council has had regard to a number of key issues, namely:

- affordability, e.g. implications for council tax/housing rents
- prudence and sustainability, e.g. implications for external borrowing
- value for money, e.g. option appraisal
- stewardship of assets, e.g. asset management planning
- service objectives, e.g. strategic planning for the authority
- practicality, e.g. achievability of the forward plan.

C2: Prudential indicator – Estimates of capital financing requirement 2014/15 to 2016/17

Indicator	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
HRA	186,566	189,665	190,800
Non-HRA	146,335	153,978	155,716
Total	332,901	343,643	346,516

The estimates are based on the financing options included in the recommended capital investment programme. The estimates will not commit the Council to particular methods of funding – the actual funding of capital expenditure will be determined after the end of the relevant financial year.

The Council has a number of daily cashflows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with the approved treasury management strategy and practices. In day to day cash management no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. It is possible, therefore, that external debt could exceed the capital financing requirement in the short term.

D. Prudential indicators for External Debt

A number of prudential indicators are required in relation to external debt.

D1: Prudential indicator – Authorised limit 2014/15 to 2016/17

Indicator	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Borrowing	427,491	448,144	462,365
Other Long Term Liabilities	1,600	1,400	1,200
Total	429,091	449,544	463,565

The authorised limit is the aggregate of gross borrowing (i.e. before investment) and other long term liabilities such as finance leases. In taking its decisions on the budget report the Council is asked to note that the authorised limit determined for 2014/15 in the above table is a statutory limit required to be determined by full Council under section 3(1) of the Local Government Act 2003.

The authorised limits are consistent with the Council's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Corporate Director of Finance and Corporate Governance and the Head of Corporate Finance confirm that they are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

D2: Prudential indicator – Operational boundary 2014/15 to 2016/17

Indicator	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Borrowing	397,491	418,144	432,365
Other Long Term Liabilities	1,600	1,400	1,200
Total	399,091	419,544	433,565

The operational boundary is based on the authorised limit but without the additional headroom. The operational boundary represents a key management tool for in-year monitoring by the Corporate Director of Finance and Corporate Governance and Head of Corporate Finance. As with the authorised limit figures for borrowing (gross) and other long term liabilities are separately identified.

The authorised limit and operational boundary separately identify borrowing from other long-term liabilities. The council is recommended to delegate authority to the Corporate Director of Finance and Corporate Governance and the Head of Corporate Finance, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the council at its next meeting following the change.

D3: Prudential indicator – HRA Limit on Indebtedness Under Self Financing

This is otherwise known as the Debt Cap, the absolute level of debt permitted under Self Financing Regulations. The debt cap is set at £188.141m, therefore all debt attributable to the HRA cannot exceed this figure.

E. Prudential indicators for Treasury Management

A number of prudential indicators are required in respect of treasury management. The indicators are based on the council's treasury management strategy and take into account the pre-existing structure of the council's borrowing and investment portfolios.

E1: Prudential indicator – Thurrock Council has adopted the "CIPFA Code of Practice for Treasury Management in the Public Services" within its Financial Standing Orders.

E2: Prudential indicators – Upper limits on interest rate exposure 2014/15 to 2016/17

Indicator	2014/15	2015/16	2016/17
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

The above percentages are calculated on the net outstanding principal sums (i.e. net of investments). The upper limit of 100% is a consequence of the council maintaining an investment portfolio. Indicator E2a exemplifies the indicator over borrowing and investment.

E2a: Prudential indicators (supplemental) – Upper limits on interest rate exposure 2014/15 to 2016/17

Indicator	2014/15	2015/16	2016/17
Upper limit on borrowing – fixed rate exposure	100%	100%	100%
Upper limit on borrowing – variable rate exposure	50%	50%	50%
Upper limit on investments – fixed rate exposure	100%	100%	100%
Upper limit on investments – variable rate exposure	50%	50%	50%

Indicator E2a is supplemental to Indicator E2 and shows separately the maximum limits for both borrowing and investments. The indicator is not a requirement of the prudential code but it does show more clearly the interest rate exposure limits within which borrowing and investments will be managed. The effect of the limits is the Corporate Director of Finance & Corporate Governance will manage fixed interest rate exposure within the range 0% to 100% for borrowing and within the range 0% to 100% for investments.

E3`; Prudential indicator – Upper and lower limits on the maturity structure of borrowing 2014/15

	Upper Limit	**Lower Limit**
under 12 months	100%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	60%	0%
10 years and within 20 years	60%	0%
20 years and within 30 years	60%	0%
30 years and within 40 years	60%	0%
40 years and within 50 years	100%	0%
50 years and above	100%	0%

The limits in Indicator E3 represent the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period.

E4: Prudential indicator – Principle sums invested for periods longer than 364 days

Indicator	**2014/15 £'000**	**2015/16 £'000**	**2016/17 £'000**
Limit	15,000	15,000	15,000

E5: Prudential indicator – Credit Risk:

- The Council employs Treasury advisors (Arlingclose) who provide monthly updates that consider security, liquidity and yield in that order, when making investment decisions.
- Credit ratings remain an important element of assessing credit risk, but, they are not a sole feature in the Council's assessment of counterparty credit risk

- The Council also considers alternative assessments of credit strength and information on corporate developments and market sentiment towards counterparties. The following key tools are used to assess credit risk:
    - Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns)
    - Sovereign support mechanisms
    - Credit default swaps (where quoted)
    - Share prices (where available)
    - Economic fundamentals, such as country's net debt as a percentage of its GDP
    - Corporate developments, news, articles, market sentiment and momentum
    - Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. All other indicators of creditworthiness are considered in relative rather than absolute terms

APPENDIX 2

Approved Investment Counterparties:

Counterparty	Cash Limit	Time limit*
Banks and other organisations rated AAA	£5m	10 years**
Banks and other organisations rated AA+	£5m	5 years**
Banks and other organisations rated AA	£5m	4 years**
Banks and other organisations rated AA-	£5m	3years**
Banks and other organisations rated A+	£5m	2 years**
Banks and other organisations rated A	£5m	1 year**
Banks and other organisations rated A-	£5m	1 year **
The Council's current account bank if it fails to meet the above criteria	£5m	Next day
UK Central Government (irrespective of credit ratings)	Unlimited	50 years***
UK Local Authorities (irrespective of credit ratings)	£5m	50 years***
UK Registered Providers of Social Housing whose lowest published long term credit rating is A- or higher	£5m	10 years***
UK Registered Providers of Social Housing whose lowest published long term credit rating is BBB- or higher and those with no credit rating	£5m	5 years
UK Building Societies with low or no credit ratings	£2m	1 year
Money Market Funds and other pooled funds	£2m	n/a
Other organisations following Council decisions – cash and term limits to be decided on each case	TBA	TBA
Any other organisation subject to an external credit assessment and specific advice from the Council's treasury management advisor	£2m	3 months
Any other organisation subject to an external credit assessment and specific advice from the Council's treasury management advisor	£1m	1 year
Any other organisation subject to an external credit assessment and specific advice from the Council's treasury management advisor	£100k	5 years
Overnight investments with organisations	£5m	Next day

* time limit is doubled for investments that are secured on the borrowers assets
** but no longer than 2 years in fixed term deposits and other illiquid investments
*** but no longer than 5 years in fixed term deposits and other illiquid investments

The above limits are the maximum that the Council would expect to have in place at any time. However, in practice the actual duration limits in place are continually assessed in conjunction with Arlingclose and will be much shorter than the limits in the above table.

There is no intention to restrict investments to bank deposits and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail in provisions in the Banking Reform Act 2014 and the EU Bank Recovery and Resolution Directive are implemented.

In addition, the Council may invest with organisations and pooled funds without credit ratings following an external credit assessment and advice from the Council's treasury management advisors.

Current Account Bank – The Council's current accounts are held with the Co-Operative Bank which is currently rated below the minimum A- rating. The Council may continue to deposit surplus cash with the Co-Operative Bank providing that investments can be withdrawn on the next working day (i.e. overnight deposits only). The Co-Operative Bank has decided to exit from Local Authority banking following their well publicised financial problems. The Council will be looking to move bankers during 2014.

Registered Providers – Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Community Agency and retain a high likelihood of receiving government support if needed. The council will consider investing with Registered Providers with adequate credit safeguards, subject to receiving independent advice.

Building Societies – The Council takes additional comfort from the building societies regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail deposits. The Council will therefore invest with low rated and unrated building societies where independent credit analysis shows them to be suitably creditworthy. The Council will make investment limit decisions based on the credit analysis information received, but, will not exceed the overall limits in the above table for low or unrated building societies. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform and investments in lower rated and unrated building societies will therefore be kept under continuous review.

Money Market Funds – These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. Funds that offer same day liquidity and aim for a constant net asset value can be used as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Other Pooled Funds – The Council will consider the use of pooled bond, equity and property funds that offer enhanced returns over the longer term, but, are potentially more volatile in the shorter term. These allow the Council to diversify asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but, are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be regularly monitored.

Other Organisations – The Council may also invest cash with other organisations, for example making loans to small businesses. Because of the higher perceived risk of unrated businesses such investments may provide considerably higher rates of return.

Specified Investments

Specified investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of one year
- meets the ‘’high credit quality’’ as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- The making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate)

Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council defines ‘high credit quality’ organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares

Non-Specified Investment Limits

	Cash Limit
Total Long Term Investments	£15m
Total Investments without credit ratings or rated below A-	£25m
Total Investments in foreign countries rated below AA+	£10m
Maximum total non-specified investments	£50m

Investment Limits

The maximum that will be lent to any one organisation (except the UK Government) is £5m. A group of banks under the same ownership, a group of funds under the same management, brokers nominee accounts, foreign countries and industry sectors will all have limits placed on them as in the table below:

	Cash Limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m
Any group of pooled funds under the same management	£20m
Negotiable instruments held in a brokers nominee account	£10m

Foreign countries (total per country)	£15m
Registered Providers in total	£10m
Building Societies in total (excluding overnight investments)	£25m
Loans to small businesses	£10m
Money Market Funds	£25m

Approved Instruments

The Council may lend or invest money using any of the following instruments:

- Interest bearing bank accounts,
- Fixed term deposits and loans,
- Callable deposits and loans where the Council may demand repayment at any time (with or without notice),
- Callable deposits and loans where the borrower may repay before maturity, but, subject to a maximum of £10 million in total,
- Certificates of deposit,
- Bonds, notes, bills, commercial paper and other marketable instruments, and
- Shares in money markets funds and other pooled funds

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate such as LIBOR, subject to the limits on interest rate exposures in the prudential indicators.

Liquidity Management

The Council maintains a cash flow spreadsheet that forecasts the Council's cash flows into the future. This is used to determine the maximum period for which funds may be prudently committed. The forecast is compiled on a pessimistic basis, with receipts under estimated and payments over estimated to minimise the risk of the Council having to borrow on unfavourable terms to meet its financial commitments.

Appendix 3

INTRODUCTION:

The rules for Minimum Revenue Provision (MRP) were set out in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. These rules have now been revised by the Local Authorities (Capital Finance and Accounting (England) (Amendment) Regulations 2008.

Authorities are required to submit to a meeting of their Council an annual statement of their policy on making MRP.

BACKGROUND:

Each year the Council borrows money in order to finance some of its capital expenditure. The loans taken out for this purpose, unlike a mortgage which is repaid in part each month, are fully repayable at a future point in time. The repayment date is chosen to secure the best financial result for the Council.

The concept of Minimum Revenue Provision was introduced in 1989 to prescribe a minimum amount which must be charged to the revenue account each year in order to make provision to meet the cost of repaying that borrowing.

The detailed rules and formulae to be used in the more recent method of calculation were laid down in the Regulations mentioned in the introduction section.

This system has now been radically revised and requires an annual statement to full Council setting out the method the authority intends to adopt for the calculation of MRP.

ISSUES AND/OR OPTIONS:

Under the old regulations Local Authorities were required to set aside each year, from their revenue account an amount that, in simple terms equalled approximately 4% of the amount of capital expenditure financed by borrowing. Local Authorities had no freedom to exercise any discretion over this requirement.

The amendment regulations introduce a simple duty for an authority each year to set aside an amount of MRP which it considers to be ‘prudent’. The regulation does not define a ‘prudent provision’ but the MRP guidance makes recommendations to authorities on the interpretation of that term.

The MRP guidance document is a statutory document and authorities are obliged by section 21 of the Local Government Act 2003 to have regard to such guidance. The guidance aims to provide more flexibility and in particular for development schemes it is possible to have an MRP “holiday” for assets or infrastructure under construction.

Officers have been in discussion with the external auditors on accounting for the wholly owned housing company, Gloriana. This has given officers an additional view of how to account for MRP on projects where a capital receipt is expected. It has been accepted that there is not a requirement to set aside MRP for loans, through prudential borrowing, that are taken by the Council for onward lending to Gloriana. The basis of this decision is that Gloriana will be making repayments at some point in the future, through either the disposal of properties or rental streams, and that these be set aside for debt repayment purposes. This approach could also be utilised for other schemes, especially in terms of regeneration and economic development purposes with Purfleet regeneration being such an example.

The operative date of the change was 31 March 2008, which means the new rules have applied since the financial year 2007/08.

The Annual MRP Statement

As stated above, Local Authorities are required under the new rules to prepare an annual statement of their policy on making MRP for submission to their full Council. This mirrors the existing requirements to report to the Council on the Prudential borrowing limit and investment policy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements. The statement must be made before the start of each financial year.

The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year in question for the borrowing that is to take place in that financial year. If it is ever proposed to vary the terms of the original statement during any year, a revised statement should be put to Council at that time.

The guidance includes specific examples of options for making a prudent provision. The aim of this is to ensure that the provision to repay the borrowing is made over a period that bears some relation to the useful life of the assets in question or where a capital receipt will be received to repay the debt in part or in full.

Proposals

In 2014/15 it is proposed to continue with the regulatory method for supported borrowing and the asset life method for Prudential borrowing as in 2013/14. If this approach is agreed, the Minimum Revenue Provision Policy Statement for 2014/15 would be as follows:

- In accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2014/15 shall be the regulatory method for supported borrowing and the asset life (equal instalment) method for Prudential borrowing except where the Head of Corporate Finance judges that there will be a capital receipt arising from the project that gave rise to the prudential borrowing that will be set aside to repay the debt.

The policy will be reviewed on an annual basis.