25 February 2015	ITEM: 10
Council	
Borrowing and Investment Annual Strategy and the Annual Minimum Revenue Provision Statement 2015/16	
Wards and communities affected: All	**Key Decision:** Key
Report of: Councillor John Kent, Portfolio Holder for Finance	
Accountable Head of Service: Sean Clark, Head of Corporate Finance	
Accountable Director: Graham Farrant, Chief Executive	
This report is Public	

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 2015/16;

b) reviews borrowing and investment strategies for 2015/16 and amends the Annual Minimum Revenue Provision Statement for both 2014/15 and 2015/16; and

c) sets out a draft Treasury Management budget for 2015/16.

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. Recommendation(s)

1.1 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 in paragraph 2.29;

d) Approve the Annual Borrowing and Investment Strategy and the Annual Minimum Revenue Provision (MRP) Statement for 2015/16 and amends the existing 2014/15 Annual Minimum Revenue Provision Statement to the following;

- **The Council will set aside an amount each year which it deems to be prudent and appropriate, having regard to statutory requirements and relevant guidance issued by DCLG; and**

e) Note the revised 2014/15 and 2015/16 borrowing and investment projections as set out in the report (paragraph 2.31).

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 2014/15 forecast for interest on borrowing and investment and forecasts the 2015/16 indicative interest payable and receivable.

Borrowing Activity 2014/15 and 2015/16

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:

	31/3/2015 Estimate £m	31/3/2016 Estimate £m	31/3/2017 Estimate £m
General Fund Borrowing CFR	124,947	154,412	164,297
HRA Borrowing CFR	171,220	184,793	187,693
Total Borrowing CFR	**296,167**	**339,205**	**351,990**
Less: External Borrowing	290,139	315,139	340,139
Internal/(Over) Borrowing	**6,028**	**24,066**	**11,851**
Less: Usable Reserves	8,000	8,000	8,000
Borrowing Requirement	**(1,972)**	**16,066**	**3,851**

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. The table above shows that in 15/16 and 16/17 it may be necessary for the Council to borrow further funds rather than rely on internal borrowing, this will be monitored on a regular basis by officers to ascertain any need to borrow and whether that borrowing is on a short or long term basis. The figures in the above table exclude any borrowing required for Gloriana.

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 treasury 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 2015/16 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, the Council will keep under review the following sources for long term and short term borrowing:

- PWLB loans and its successor body;
- 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; and
- Structured finance, such as operating/finance leases, hire purchase.

Private Finance Initiative or sale and leaseback.

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 could now be amended at the request of the lender only 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 the Cabinet on a regular basis during 2015/16.

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 2015/16 and 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 or in part, 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 September 2015 and then in only gradual increases with an anticipated base rate of between 1.50%-2.25% by March 2018. The normalised level of the bank base rate post-crisis is expected to be between 2.50%-3.50%.

2.14 Based on this outlook, officers will continue to borrow on a short term basis as and when required while monitoring interest rates to ensure action to fix borrowing is taken if required.

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, or indeed from bidding for increases to the debt cap where considered prudent.

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 The Council terminated the use of Investec as Fund Managers and the £20m invested was returned to the Council. The Council subsequently re-invested the funds with the CCLA Property Fund.

2.20 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.

2.21 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, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

2.22 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.

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

2.24 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.

2.25 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.

2.26 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

2.27 Local Authorities are required to prepare an Annual Statement of their policy on making MRP for each financial year. Appendix 3 outlines the Council's Annual MRP Statement for 2015/16 (and which is also amended for 2014/15)and is included as item (i) in the Annual Strategy in paragraph 2.30. This has been amended to meet the overall requirement of making a prudent provision rather than applying a specific methodology. This is in accordance with good practice and is consistent with advice received from our Treasury Management advisors.

2.28 Officers have reviewed the current strategy and recommend that the only further revision to the strategy for 2015/16 is to take out any reference to Investec as Fund Managers and replace it with reference to the CCLA Property Fund.

2.29 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 2015:

a) To obtain any long term borrowing requirement from the sources of finance set out 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 further funds into the CCLA Property Fund if it is felt prudent to do so; and
i) In accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 The Council will set aside an amount each year which it deems to be prudent and appropriate, having regard to statutory requirements and relevant guidance issued by DCLG.

Interest Projections 2014/15 Revised and 2015/16 Original

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

2.31 The 2014/15 budget and the final projected position for 2014/15 and also an initial projection for 2015/16 are shown in summary format in table 2 below: -

		Budget 2014/15 £000's	Projected 2014/15 £000's	Original 2015/16 £000's
	Interest payable on External Debt			
1.	Debt Interest	2,303.0	2,296.8	2,728.9
2.	Total internal interest	-106.9	109.0	109.0
3.	Interest payable	2,196.1	2,405.8	2,837.9
	Investment Income			
4.	Interest on Investments	-593.3	-565.8	1,055.6
5.	Net interest charged to General Fund	1,602.8	1,840.0	1,782.3
6.	MRP- Supported/Unsupported Borrowing	5,800.0	5,497.5	5,623.6
7.	Overall charge to GF	7,402.8	7,337.5	7,405.9

2.32 It should also be noted that the figures shown above for 2015/16 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.

2.33 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 foreseeable future. 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 (including Overview and Scrutiny, if applicable)

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 savings in the region of £16m to date.

7. Implications

7.1 **Financial**

Implications verified by: **Chris Buckley**
Treasury Management Officer

The financial implications are included in the main body of the report.

7.2 **Legal**

Implications verified by: **David Lawson**
Deputy Head of Legal

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: **Natalie Warren**
Community Development and Equalities Manager

There are no direct diversity implications noted in this report

7.4 **Other implications** (where significant) – i.e. Staff, Health, Sustainability, Crime and Disorder)

Not applicable.

8. Background papers used in preparing the report (including their location on the Council's website or identification whether any are exempt or protected by copyright):

- 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
- 2014/15 Annual Investment Strategy
- Arlingclose's Investment Review.

9. Appendices to the report

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

Report Author:

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Treasury Management Officer