24 February 2016	ITEM: 13
Council	
TREASURY MANAGEMENT STRATEGY 2016/17	
Portfolio Holder: Councillor John Kent, Portfolio Holder for Finance and Strategy	
Wards and communities affected: All	**Key Decision:** Yes
Accountable Head of Service: N/A	
Accountable Director: Sean Clark, Director of Finance and IT	
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. Sets out the Treasury Management strategy for 2016/17;
b. Confirms the proposed Prudential Indicators for 2016/17; and
c. Sets out the Treasury Management projections for 2016/17.

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.

1. Recommendation(s)

1.1 That the Council:

a. Approve the Treasury Management Strategy for 2016/17 and its application to 2015/16 including approval of the Annual Minimum Revenue Provision (MRP) Statement for 2016/17 and its application to 2015/16;

b. Approve the adoption of the Prudential Indicators as set out in Appendix 1;

c. **Delegate the approval of any changes to the Prudential Indicators to Cabinet where required due to the delivery mechanism for affordable homes in the borough as outlined in paragraph 2.16; and**

d. **Note the revised 2015/16 and 2016/17 Treasury Management projections as set out in paragraph 2.34.**

2. Introduction and Background

2.1 The Treasury Management Strategy and Annual MRP Statement are prepared under the terms of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code) and approval is sought for the adoption of the Prudential Indicators that have been developed 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 these documents in compiling this report.

2.2 The report also revises the 2015/16 forecast for interest on borrowing and investment and forecasts the 2016/17 indicative interest payable and receivable.

Borrowing Activity 2015/16 and 2016/17

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 set out on the following page.

	31/3/2016 Estimate £m	**31/3/2017 Estimate £m**	**31/3/2018 Estimate £m**
General Fund Borrowing CFR	159,952	176,417	183,265
Housing Revenue Account Borrowing CFR (includes effects of Housing Finance Reform based on current available figures)	184,067	201,811	205,890
Total Borrowing CFR	**344,019**	**378,228**	**389,155**
Less: External Borrowing	339,889	339,889	369,889
Internal/(Over) Borrowing	**4,130**	**38,339**	**19,236**
Less: Useable Reserves	8,000	8,000	8,000
Borrowing Requirement	**-3,870.0**	**30,339**	**11,236**

2.4 The Council's level of physical debt and investments is calculated by reference to the Council's balance sheet. The Council's main objectives when borrowing money are to secure low interest costs and achieve cost certainty over the period for which funds are required. A further objective is to provide the flexibility to renegotiate loans should the Council's long term plans change.

2.5 Given the ongoing significant cuts to local government funding, the Council's borrowing strategy continues to balance affordability and the longer term stability of the debt portfolio. Given the availability of low short term interest rates it is more cost effective to either use internal resources, or to borrow over short term periods. The table above shows that in 2016/17 and 2017/18 it may be necessary for the Council to borrow further funds and this will be monitored on a regular basis by officers to assess the most appropriate form of borrowing.

2.6 This enables the Council to reduce borrowing costs (despite forgone investment income) and reduce the overall treasury risk. While 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 sustainable 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 assessment and breakeven analysis. This will help inform whether the Council borrows additional sums at long term fixed rates in 2016/17 with a view to keeping future interest costs low, even if this causes additional costs in the short term.

2.7 In addition, the Council may use short term loans (normally up to one month) to manage the Council's cash flow.

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:

- Public Works Loan Board (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;
- UK Municipal Bonds Agency;
- Special purpose companies created to enable joint local authority bond issues;
- Local Authority bills;
- Structured finance, such as operating/finance leases, hire purchase, Private Finance Initiative or sale and leaseback.

2.9 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.

2.10 Borrowing and rescheduling activity will be reported to the Cabinet on a regular basis during 2016/17.

2.11 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. To the end of 2014/15 the rescheduling had saved £15.5m of interest cost and is estimated to have saved £18.8m by the end of 2015/16. Currently financing from short term money market debt is expected to continue into 2016/17. The inherent risk of this strategy is noted with potentially higher rates and increased debt costs in the future.

2.12 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. It is expected official rate increases will not occur until September 2016. Subsequently only gradual increases to the base rate of between 1.50% to 2.25% are anticipated by March 2018. The normalised level of the bank base rate post-crisis is expected to be between 2.50% to 3.50%.

2.13 Based on this outlook, officers will continue to borrow on a short term basis when required while monitoring interest rates to ensure borrowing is fixed if required.

2.14 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.

2.15 On 1 April 2012, the Council notionally split each of its existing long-term loans into General Fund and Housing Revenue Account (HRA) pools. New long-term loans will be assigned in their entirety to one pool or the other. Interest payable and other costs and income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged or 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 a commercial rate. This is likely to require changes to the Council's prudential indicators and it is requested these changes 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 and, with a likely increase over the period of development, this would affect the Authorised and Operational Borrowing Limits and any affected Capital Indicators.

2.17 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 such as capital receipts from Council house sales, other cash backed resources, or through bidding for increases to the debt cap where considered prudent.

2.18 Finally, there are significant regeneration programmes and opportunities being considered and progressed at this time. The need to borrow for investment will be considered on a case by case basis.

Investments

2.19 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. It is envisaged that investment balances will be approximately £15 million at the financial year end. The Council may invest its surplus funds with any of the counterparties detailed in Appendix 2.

2.20 The Council held £20m invested in the CCLA Property Fund at the end of 2014/15. The 2015/16 Treasury Management Strategy allowed for additional amounts to be added to the fund if deemed appropriate. The Director of Finance and IT, using powers delegated to him under the Treasury Policy Statement approved by Council and the associated Treasury Management Practices, increased the investment in the Fund by £10m in July 2015. A further £20m was then invested in November 2015 to bring the total invested to £50m. These increases were reported to members in the2015/16 Treasury Mid-Year Review report. The expected return net of fees in 2015/16 is estimated to be 5% with income in the region of £1.7m and assuming a similar net return of 5% in 2016/17, returns should be in the region of £2.5m.

2.21 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.

2.22 The Council 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 Council 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.

2.23 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.

2.24 The Council complies with the provisions of s32 of the Local Government Finance Act 1992 to set a balanced budget.

2.25 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 attend courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are encouraged to study for professional accountancy qualifications from appropriate bodies.

2.26 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 assessed by regular review meetings between Arlingclose Ltd and officers from the Council.

2.27 The Council may 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 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 Minimum Revenue Provision Statement

2.28 Local Authorities are required to prepare an Annual Statement of their policy on making MRP for each financial year. Appendix 3 outlines the assessment of the Council's Annual MRP Statement for 2016/17, which is included as item (i) in the Annual Strategy in paragraph 2.30.

2.29 Officers have reviewed the current strategy and recommend two amendments to the 2015/16 strategy and hence also impact on the 2016/17 strategy. These are to take out any reference to Investec as Fund Managers and replace it with reference to the CCLA Property Fund and to enable officers consider the use of capital receipts to pay the annual MRP charges.

2.30 Therefore, with regards to the following paragraphs on Borrowing Activity and Investments the following statement form part of the Council's Treasury Management Strategy with effect from 1 April 2016 and also apply to the 2015/16 strategy:

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) To repay market loans that require 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) To 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) To ensure security and liquidity of the Council's investments and to then optimise investment returns commensurate to those ideals;
g) To contain the type, size and duration of investments with individual institutions within the limits specified in Appendix 2;
h) To move further funds into the CCLA Property Fund if it is felt prudent to do so; and
i) To meet the requirements of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2016/17 shall be that 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. The Council will also consider the use of capital receipts to pay down any MRP incurred.
j) To ensure all borrowing and investment activities are made with due reference to any relevant Prudential Indicators.

The Prudential Indicators

2.31 The prudential indicators are monitored by the Council to ensure that capital investment is affordable, prudent and sustainable. The indicators are reassessed annually to ensure their continuing relevance and appropriateness to the Council.

2.32 The proposed indicators for 2016/17 are set out in Appendix 1 to this report.

Interest Projections 2015/16 Revised and 2016/17 Original

2.33 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.

2.34 The 2015/16 budget and the projected position for 2015/16 as at December 2015 and also an initial projection for 2016/17 are shown in summary format in table 2 below.

		Budget 2015/16 £000's	Projected 2015/16 £000's	Budget 2016/17 £000's
	Interest payable on External Debt			
1.	Debt Interest		2,437.7	2,824.9
2.	Total internal interest		116.0	154.0
3.	Interest payable	2,980.0	2,553.7	2,978.9
	Investment Income			
4.	Interest on Investments	-1,055	-1,947.2	-3,364.8
5.	Net interest charged to General Fund	1,925.0	506.7	-385.9
6.	MRP- Supported/Unsupported Borrowing	5,982.0	3,696.8	4,586.6
7.	Overall charge to GF	7,907.0	4,203.5	4,200.8

2.35 It should also be noted that the figures shown above for 2016/17 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 may be liable to a significant degree of change during the year arising from variations in interest rates, other market and economic developments, and officers' response to those events.

2.36 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 The strategy of the Council is contained within the body of the report and has been set with consideration of relevant legislation and appropriate guidance. The Prudential Indicators are governed by decisions made on the revenue and capital budgets.

3.2 There are three 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.
c) The approach taken to the minimum revenue provision.

4. Reasons for Recommendation

4.1 There is a legal requirement for a Treasury Management Annual Strategy and the Annual Minimum Revenue Provision Statement to be ratified by Full Council. This report and appendices have 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**
Corporate Finance

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

7.2 Legal

Implications verified by: **David Lawson**
Monitoring Officer

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: **Rebecca Price**
Community Development Officer

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
- 2015/16 Annual Investment Strategy
- Arlingclose's Investment Review.

9. Appendices to this Report

- Appendix 1 – Prudential Indicators
- Appendix 2 – Specified and Non-Specified Investments
- Appendix 3 – Annual Minimum Revenue Provision Statement

Report Author

Chris Buckley

Treasury Management Officer

Corporate Finance