Part I
Release to Press

Meeting:	**AUDIT / EXECUTIVE / COUNCIL**	**Agenda Item:**	**4**
Portfolio Area:	**Resources**		
Date:	**2 FEBRUARY /10 FEBRUARY / 25 FEBRUARY 2015**		

PRUDENTIAL CODE INDICATORS AND TREASURY MANAGEMENT STRATEGY 2015/16

NON-KEY DECISION

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1 PURPOSE

1.1 To recommend to Council the approval of the Treasury Management Strategy 2015/16 including its Annual Investment Strategy and the Prudential Indicators.

2 RECOMMENDATIONS

2.1 That Executive recommend to Council to adopt the 2015/16 Treasury Management Strategy as detailed in Appendix A.

2.2 That Executive recommend to Council to adopt the Prudential Code Indicators as detailed in Appendix A, Attachment Two.

2.3 That any comments on this report and/or decisions from the Audit Committee be reported to Executive and Council.

3 BACKGROUND

3.1 It is a requirement of the Local Government Act 2003 that from April 2004 Councils must 'have regard to the Prudential Code and set Prudential Indicators to ensure that capital investment plans are affordable, prudent and sustainable'.

3.2 The 2015/16 Strategy incorporates improvements that have been made to the current years strategy as part of the 2013/14 outturn and 2014/15 mid-year review reported to Council on 8th October 2014. The Strategy is also aligned to the Housing Revenue Account (HRA) Business Plan, the Council's General Fund Medium Term Financial Strategy (MTFS) and Capital Strategy. The ongoing review of the Strategy is undertaken with regard to the CIPFA code of practice.

3.3 Since the collapse of the Icelandic banks in 2008, the ensuing turbulence in the financial markets and down-ratings of both countries and counterparties by the major credit agencies have presented an ongoing requirement to ensure that Treasury Management policies and practices manage and minimise the Council's exposure to risk.

3.4 The Chartered Institute of Public Finance Accountants (CIPFA) updated the Treasury Management in Public Services Code of Practice (the Code) and the requirements for the Treasury Management Policy Statement. It is a requirement of the code of practice that the Code is formally adopted by the Council which was mandatory from 1 April 2010.

3.5 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 (The Act), for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that arise as a result of capital financing decisions. This means that increases in capital expenditure must be limited whereby increases in charges to revenue remain affordable within the projected income of the Council for the foreseeable future. The costs included in the Treasury Management Prudential Indicators reflect the costs identified in the Council's General Fund and HRA Budgets for 2015/16.

3.6 The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

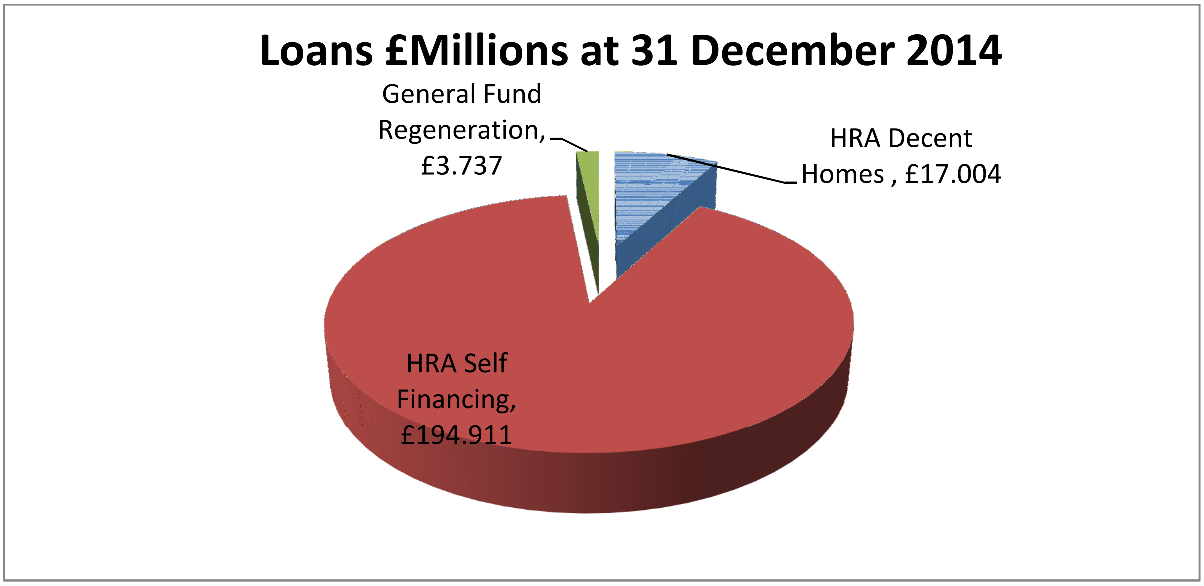
3.7 This Strategy's Prudential Indicators (Appendix A, Attachment Two) includes HRA debt (relating to the HRA self-financing and Decent Homes Programme), and General Fund prudential borrowing.

3.8 This report bases its prudential indicators on the Draft Capital Strategy reported to the Executive in January 2015. The Audit Committee is the body nominated to provide scrutiny for the Treasury Management Strategy prior to approval at Council. Any comments that the Audit Committee has on the Strategy will be reported to Executive (10 February 2015) and to Council (25 February 2015).

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 Update on the Treasury Management Strategy

4.1.1 The Council's external debt was £215.652Million as at 31 December 2014. This can be broken down as follow:



4.1.2 Loan repayments made in 2014/15 relate to the General Fund. £131,579 repaid in August 2014, with a further repayment of £131,579 due in February 2015. There is £263,158 to be repaid in 2015/16.

4.1.3 There are no loan repayments due in 2014/15 for the HRA and as at the 31 March 2015 the total HRA loans outstanding is forecast to be £211,915,000, which is £5,770,000 below the debt cap of £217,685,000. There is a repayment of £5,500,000 to be repaid in 2015/16.

4.1.4 Since 2011/12 the Council has required £13,542,264 of borrowing (up to and including the current year) to fund its capital programme. However only loans of £4,000,000 have been taken and the General Fund will have already set aside £1,303,954 of Minimum Revenue Payment (MRP) to meet the borrowing cost by 31 March 2015 as shown in the table below.

Financial Year	General £	Regeneration Initiatives £	Total £	MRP repaid £	MRP remaining £
2011/12	1,803,028		1,803,028	309,050	1,493,978
2012/13	1,560,314	7,039,448	8,599,762	894,595	7,705,166
2013/14	1,802,457	28,317	1,830,774	78,497	1,752,277
2014/15	0	1,308,700	1,308,700	21,812	1,286,888
Total	**5,165,799**	**8,376,465**	**13,542,264**	**1,303,954**	**12,238,310**

4.1.5 Cash and investment balances have been used in preference to taking external loans (effectively internal debt). The cost of the internal debt is the average investment interest foregone currently at a rate of 0.47% (actual average interest rate from 1 April 2014 to 31 December 2014). This is significantly lower than the cost of borrowing externally at 3.04% (based on PWLB's 25 year maturity rate on 15 January 2015).

4.1.6 How long can this strategy continue? It is the view of the Assistant Director (Finance) and the Chief Financial Officer that this approach will continue while investment balances remain high in the medium term and interest rates remain relatively low. This approach has largely been in place since 2011/12 and effectively the General Fund is reducing the amount it would need to borrow by the amount of MRP set aside.

4.1.7 The Council's treasury advisors (Capita Treasury Services) also monitor PWLB and market borrowing rates and identify trigger rates at which it may be prudent to take borrowing. The Treasury Team is mindful of these rates and takes this advice into consideration along with projections for cash balances. Should interest rates rise and or cash balances fall, circumstances may dictate that it would be preferential to borrow rather than use cash balances. Officers will continue to monitor the position.

4.1.8 It is not the intention of the Council to borrow in advance of need. However, should this happen as part of optimising the treasury management position of the Council and minimising risk, the transaction will be accounted for in accordance with proper practices.

4.1.9 The projection when the Bank of England Base Rate will rise continues to be extended as the Council's treasury advisors now forecast a rise in December 2015. Based on this assumption the Council has forecast average investment returns for 2014/15 of 0.48%, and is budgeting for returns of 0.63% in 2015/16.

4.1.10 The Treasury's Certainty Rate for borrowing remains available and enables the Council to take out PWLB loans at 20 basis points below the standard PWLB rate. The 25 year PWLB rate quoted in paragraph 4.1.5 includes that adjustment.

4.1.11 Members may be aware that there is a current proposal to abolish the PWLB (Public Works Loan Board) and to transfer its lending functions to another body using the process set out in the Public Bodies Act 2011. The Government has given the assurance that the proposals will have no impact on existing loans held by local authorities or the government's policy on public sector borrowing.

4.1.12 The Council complies fully with the CIPFA Treasury Management Code 2011, the Guidance on Self Financing and the investment guidance issued by Communities and Local Government (CLG). The following are areas kept under review:

a) A Treasury Management presentation was provided to the Audit Committee on 26th November 2014, and is planned for future years.

b) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

c) A full mid-year review of Treasury Management Strategy and performance will be reported in 2015/16.

4.1.13 The 2014/15 Strategy uses the creditworthiness service provided by Capita Treasury Services. However the Strategy has been updated for the removal of Individual Support Ratings from the criteria because they are no longer used. (Please refer to Appendix A Attachment Three for the Council's Specified and Non-specified Investment Criteria.)

4.1.14 The proposed changes to the minimum credit quality criteria for Specified and Non-Specified Investment, together with Treasury Limits are detailed below, (a summary of all investment criteria and limits, together with procedures, is provided in Appendix A Attachment Three).

- **Specified and Non-specified Limits**

Counter-party	Investment Instrument	Previous Criteria	Proposed Minimum Credit Quality Criteria	Para
Banks or Building Societies (Specified Investment)	Overnight Deposit	Not mentioned	Treat as 'Call Accounts' due to its next day liquidity	
	Call Account	Short term F1	Fitch: Short Term F1 and Moody, Standard & Poor, equivalent where rated and the lowest rating used where different; OR Part-nationalised or Nationalised UK banking institutions (subject to regular review of government shares percentage)	4.1.15
	Notice Account up to one year notice period	Not mentioned	Clarified to be the same as Short Term Deposit due to its fixed term nature defined by the notice period	
	Short Term Deposit up to one year	Short term F1+ and lower in line with cascade of F1+, F1 part nationalised and other F1, Long Term AA-, Individual C, Support 3	Fitch: Short Term F1; Long Term A and Moody, Standard & Poor, equivalent where rated OR Part-nationalised UK Institutions	4.1.16 4.1.17
Banks or Building Societies (Non-specified Investment)	Long Term Deposit up to five years	Short term F1+, Long term AA-, Individual C, Support 2	Fitch: Short Term F1; Long Term AA- and Moody, Standard & Poor, equivalent where rated	4.1.15

- **Treasury Limits**

Proposed change	Cash balances less than £30Million	Cash balances higher that £30Million	Para.
	Limits	Limits	
Overnight and Instant Access (or Call Accounts)	Subject to the same investment limits of £10Million minimum and up to 100% maximum. (Previously, Instant Access was £10M minimum and Overnight was £20M maximum)		4.1.19
Fixed Rate less than 12 month maturity	The first £10Million of investments to be instant access funds. Above £10Million can be 100% less £10Million Instant Access (Previously, the limit £15Million)		4.1.20

4.1.15 The Council uses the rating criteria supplied by the Council's treasury advisors which now uses all three ratings agency (previously two), which complies with the CIPFA code of practice.

4.1.16 Fixed term deposits were invested based on a cascade which was F1+, part nationalised then F1. It is proposed to remove the cascade as the number of counterparties available is restricted as can be seen from the chart below.

Credit Ratings 20/1/15 (of Banks, Building Societies meeting the Council's credit criteria)

	Fitch	Moody's	S & P	Fitch	S & P	Capita Suggested Max Duration (of Investment)
	Short Term			Long term		
HSBC	F1+	P-1	A-1+	AA-	AA-	12 Months
Svenska Handelsbanken	F1+	P-1	A-1+	AA-	AA-	12 Months
Lloyds Banking Group	F1- part nationalised	P-1	A-1	A	A	12 Months
Royal Bank of Scotland Group	F1- part nationalised	P-2	A-2	A	BBB +	12 Months
Santander UK	F1	P-1	A-1	A	A	6 Months
Barclays	F1	P-1	A-1	A	A	6 Months
Nationwide B.S	F1	P-1	A-1	A	A	6 Months

4.1.17 The only F1+ banks in the market for short term investments are HSBC and Handelsbanken, the former being the Council's own bank and some headroom is required for cash balances held in the Council's bank account. It is proposed to remove the cascade, and permit fixed term investment with counterparties meeting the minimum F1 criteria in any order. Under Capita's colour coded durational bands the F1 rating (or equivalent) means investments are placed up to a maximum of 6 months while F1+ means a maximum duration of 12 months.

4.1.18 All three rating agencies are used (where rated) to be consistent with the Treasury Advisor's methodology (Capita's Credit Policy Guide 2013/14). Individual and Support Ratings are no longer relevant indicators, and therefore are removed.

4.1.19 Overnight and instant access investmets have next day cash liquidity, therefore are now subject to the same investment limits. Maximum is specified up to 100% of cash holding to reduce liquidity risk.

4.1.20 In order to manage the investment portfolio more effectively and with the rate rise assumed now to be December 2015, it is proposed to increase the limit for short term investment to the maximum cash balance less the £10Million minimum holding in instant access or overnight investments.

4.1.21 As part of the update and review of the 2015/16 Strategy a previous change has been clarified. In the original 2014/15 Strategy there was a limit set for the maximum investment in money market funds (£5Million), however a subsequent update approved as part of the mid-year review recommended that when balances are in excess of £30Million, counterparty limits are increased to £7Million. This Strategy clarifies that counterparties **includes** Money Market funds.

4.2 Prudential Code Indicators

4.2.1 The prudential code indicators as shown in Appendix A, Attachment Two have been updated for 2015/16 and subsequent years. The 2015/16 **net borrowing requirement indicator** (Appendix A, attachment 2, 3c) is forecast at £165.768Million (2014/15: £164.844Million) which is the total of loans taken less investment held. The detail is shown in the table below.

	2014/15	**2015/16**
	£000	**£000**
Loans HRA	211.915	206.415
Loans General Fund	3.605	4.651
Investments	(50.677)	(45.298)
Total	**164.844**	**165.768**

4.2.2 The Council's underlying need to prudentially borrow for the General Fund (as measured by the General Fund forecast capital financing requirement (GF CFR)), is £16.441Million for 2014/15, and £15.787Million for 2015/16 (Appendix A, attachment 2, 4) . This indicator is the amount of capital expenditure that has been financed from borrowing, less any adjustments for statutory repayments (MRP) and any other adjustments relating to the transfer of assets between the General Fund and HRA.

4.2.3 The associated revenue costs of borrowing have been included in the Council's General Fund Budget. The incremental impact of the Council's previous borrowing requirements and spend contained in the draft 2015/16 Capital

Strategy is estimated to be a reduction of £0.44 per band D property in 2014/15 and a reduction of £11.88 in 2015/16 (Appendix A, attachment 2, 5). The reduction in 2015/16 is because of the use of the Capital Reserve and capital receipts rather than prudential borrowing.

4.3 Treasury Management Strategy

Housing Revenue Account

4.3.1 The HRA paid £199.911Million to the Government with the introduction of self-financing in effect to 'buy' itself out of the HRA subsidy system. This combined with the existing £17.774Million decent homes debt represents the debt cap for the HRA (£217.685Million). The HRA is not allowed (by legislation implemented as part of the self- financing regime) to borrow above this amount.

4.3.2 As at 31 March 2016 the HRA will be £11.27Million below its debt cap, (31 March 2015 £5.77Million below). There are currently no plans within the current HRA Business Plan to refinance or take additional borrowing. All of the HRA debt is projected to be repaid by 28 March 2040. The reduction in 2015/16 in HRA borrowing is because £5.5Million will be repaid in 2015/16.

4.3.3 The Authorised Limit for borrowing or the limit above which further approval is required from Council is shown in the Prudential Indicators (Appendix A, attachment 2, 3a). For the HRA this limit must below the debt cap of £217.685Million. All planned capital expenditure on the HRA is funded from resources available either from the Housing Revenue Account, other contributions or from grant funding. However the current HRA Business Plan has identified a shortfall in funding of £15.4Million within the next 30 years, which will have to be addressed. This shortfall will be reviewed as part of the next update in July 2015.

4.3.4 The HRA CFR indicator (Appendix A, attachment 2, 4), includes the appropriation of land and dwellings in 2013/14 from GF to HRA with due regard to comply with the Council's borrowing limits on external debts. There are currently no planned appropriations in 2014/15 or 2015/16.

4.3.5 The Council has adopted a two debt-pool model, where loans are individually identified for each fund. Where new HRA loans are required but a loan is not taken out, effectively internal borrowing, this will result in an unfunded HRA CFR with the cash overdrawn position being dealt with through the interest on balances calculation. Where it is mutually beneficial the Council may move existing loans from the General Fund portfolio to the HRA portfolio and vice versa, recognising an internal premium or discount. This will avoid physically repaying and reborrowing, which would incur significant loss on the repayment spread (particularly in the PWLB).

General Fund

4.3.6 The General Fund has an underlying need to borrow to meet both its share of historical apportioned debt prior to HRA self financing and to finance its capital programme from 2011/12 onwards.

4.3.7 The Council's General Fund Capital Financing Requirement (Appendix A, attachment 2, 4) is estimated at £16.441Million for 2014/15, and £15.787Million for 2015/16.

4.3.8 The Council has budgeted to take out £1.8Million approved prudential borrowing in 2015/16 (relating to 2014/15), if the interest rate rises above the current forecast level or if the cash balance becomes too low. The Draft Capital Strategy to the January Executive recommended that if interest budgets are not required, that they are transferred to the capital reserve to help fund the future capital programme.

5. Implications

5.1 Financial Implications

5.1.1 The report is of a financial nature and outlines the Prudential Code Indicators and the principles under which the Treasury Management functions are managed.

5.2 Risk implications

5.2.1 The current policy of not borrowing externally only remains financially beneficial while prevailing differentials between investment income rates and borrowing rates remain, and balances remain buoyant. When this changes, the Council may need to borrow at a higher rate, leading to a significant additional revenue cost in the one year.

5.3 Legal Implications

5.3.1 Approval of the Prudential Code Indicators and the Treasury Management are intended to ensure that the Council complies with relevant legislation and best practice.

5.4 Policy Implications

5.4.1 The proposed limits are in line with policy.

5.5 Equalities and Diversity Implications

5.5.1 All the services identified in the report have their own Equalities Impact Assessments, which are reviewed where appropriate.

6. BACKGROUND DOCUMENTS

Annual Treasury Management Review of 2013/14 and Mid-Year Review Report for 2014/15, 8th October 2014, Council

7. APPENDICES

- Appendix A – Treasury Management Strategy
- Appendix A Attachment One – Minimum Revenue Provision Policy
- Appendix A Attachment Two – Prudential Indicators
- Appendix A Attachment Three – Specified and Non-specified Investment Criteria
- Appendix A Attachment Four – Approved Countries for Investment