Part I – Release to Press

Meeting:	**AUDIT / EXECUTIVE / COUNCIL**	**Council Agenda Item:**	**12**
Portfolio Area:	Resources		
Date:	**1 FEBRUARY / 9 FEBRUARY / 24 FEBRUARY 2016**		

PRUDENTIAL CODE INDICATORS AND TREASURY MANAGEMENT STRATEGY 2016/17

KEY DECISION

Authors – Sarah Ball Ext. 2351 and Clare Fletcher Ext 2933
Lead Officer – Scott Crudgington Ext. 2185
Contact Officer – Clare Fletcher Ext. 2933

1. PURPOSE

1.1 To recommend to Council the approval of the Treasury Management Strategy 2016/17 including its Annual Investment Strategy and the prudential indicators.

2. RECOMMENDATIONS

2.1 That Council be recommended to adopt the 2016/17 Treasury Management Strategy as detailed in Appendix A to the report.

2.2 That Council be recommended to Council to adopt the Prudential Code Indicators as detailed in Appendix C to the report.

2.3 That Council be recommended to note that there will be a fundamental review of the Treasury Management Strategy in 2016/2017.

2.4 That any further comments be reported to 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 2016/17 Strategy incorporates improvements that have been made to the current year's strategy as part of the 2014/15 outturn and 2015/16 mid-year review reported to Council on 9 December 2015. 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 There has been an ongoing requirement to ensure that Treasury Management policies and practices manage and minimise the Council's exposure to risk. In the last ten years there has been the collapse of the Icelandic banks impacting on some Local Authorities (2008), uncertainty in the financial markets and down-ratings of countries and counterparties by the major credit agencies.

3.4 In response to this 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 now a requirement of the Code of Practice that the Code is formally adopted by the Council.

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 Revenue and capital budgets for 2016/17.

3.6 The Act requires the Council to set out its treasury management 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 C) includes HRA debt (relating to the HRA self financing and Decent Homes Programme), and General Fund prudential borrowing.

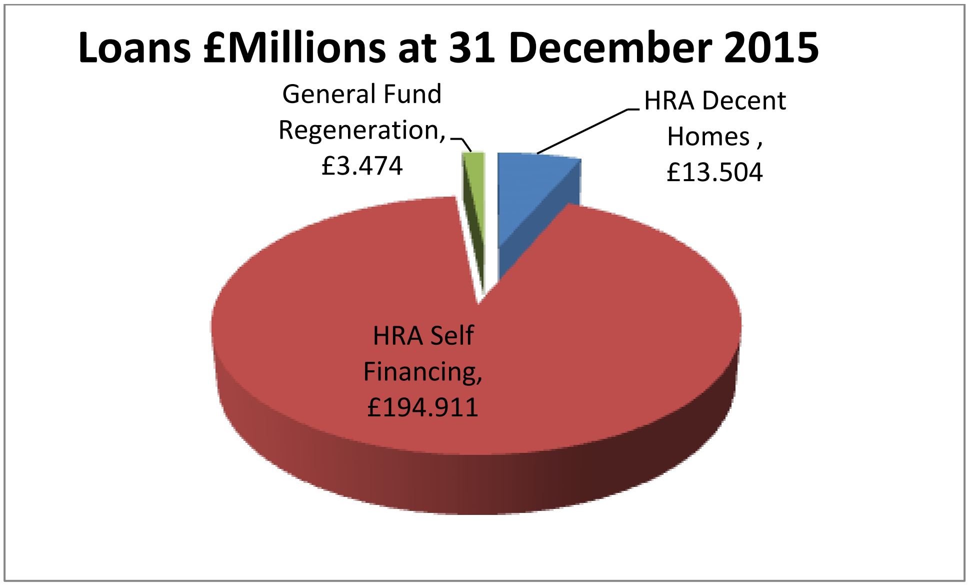
3.8 This report bases its prudential indicators on the Draft Capital Strategy reported to the Executive in January 2016. The Audit Committee is the body nominated to provide scrutiny for the Treasury management strategy prior to approval at Council. Any comments that the Audit Committee has on the Strategy will be reported to Executive (9 February 2016) and to Council (24 February 2016).

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 Update on the Treasury Management Strategy

The Council's Borrowing Position

4.1.1 The Council had external debt of £211.889Million as at 31 December 2015. This can be broken down as follows:



4.1.2 In 2015/16 there were loan repayments (HRA) of £3.5Million (£2.5Million July 2015 and £1Million October 2015), with £2Million to be repaid in March 2016. As at the 31 March 2016 the total HRA loans outstanding is forecast to be £206,415,000, with no loan repayments scheduled in 2016/17 for the HRA.

4.1.3 In 2015/16 there were loan repayments (General Fund) of £131,579 (August 2015) with a further £131,579 to be repaid in February 2016. For 2016/17 a further £263,158 will be repaid.

4.1.4 Since 2011/12 the Council has required £13,542,264 of General Fund 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 has already set aside £1,957,583 of Minimum Revenue Payment (MRP) to meet the borrowing cost by 31 March 2016.

4.1.5 Repayment of the principle as outlined in paragraph 4.1.3 is different to the MRP as set out in the table below. The General Fund is required to make a minimum revenue provision based on the life of the asset funded from borrowing regardless of whether the loan has been taken, (see also Appendix B). The physical principal repayment is a Treasury Management decision and is not charged to the General Fund.

Financial Year	General £	Regeneration Initiatives £	Total £	MRP Repaid £	MRP Remaining £
2011/12	1,803,028	0	1,803,028	408,000	1,395,028
2012/13	1,560,314	7,039,448	8,599,762	1,318,428	7,281,334
2013/14	1,802,457	28,317	1,830,774	156,995	1,673,779
2014/15	0	1,308,700	1,308,700	74,160	1,234,540

2015/16	0	0	0	0	0
Total	**5,165,799**	**8,376,465**	**13,542,264**	**1,957,583**	**11,584,681**

4.1.6 Cash and investment balances (effectively internal borrowing) have been used in preference to taking external loans. This is because the cost of the internal debt in effect the average investment interest foregone (currently 0.60%), is significantly lower than the cost of borrowing externally at 3.44% (based on 25 year maturity rate on the 29th December 2015).

4.1.7 It is the view of the Chief Financial Officer that this approach will continue while cash balances remain high in the short to medium term and interest rates remain relatively low. This approach has been taken since 2011/12 and with the MRP set aside (as shown in table in 4.1.5) the General Fund is effectively reducing the amount it would need to borrow and that need will have reduced by £1.9Million at 31 March 2016.

4.1.8 The Council's treasury advisors (Capita Treasury Services) also monitor Public Works Loan Board (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 externally borrow rather than use cash balances. Officers will continue to monitor the position.

4.1.9 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.

4.1.10 The Council's treasury advisors now forecast the next Bank of England Base Rate rise in December 2016 (the 2015/16 Treasury Management Strategy had previously forecast a rise in December 2015). Based on a December 2016 Base Rate increase Council has forecast average investment returns for 2015/16 of 0.58%, and is budgeting for returns of 0.70% in 2016/17.

4.1.11 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 4.1.6 includes that adjustment.

4.1.12 Members may be aware that there is a proposal to abolish the PWLB 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 Local Authority borrowing.

Investments

4.1.13 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 last provided to the Audit Committee on 26th November 2014. Training will be provided as required in 2016/17.

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

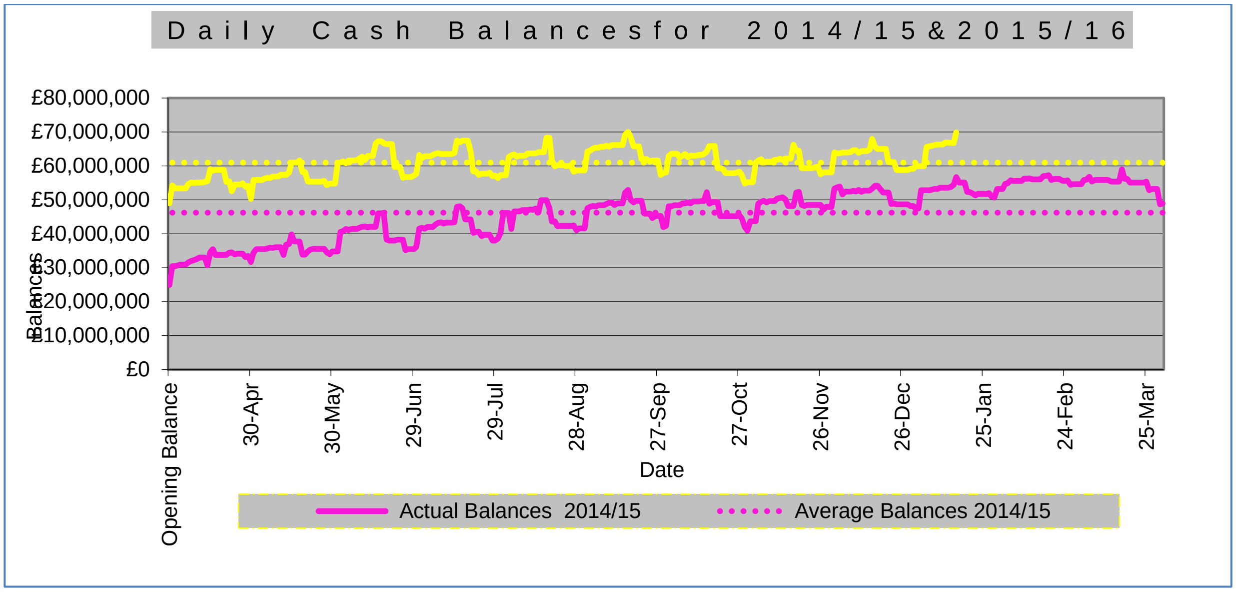
c) A full mid-year review of treasury management strategy and performance will be reported in 2016/17.

4.1.14 The 2016/17 Strategy uses the creditworthiness service provided by Capita Treasury Solutions, which complies with the CIPFA Code of Practice. This service uses a sophisticated modelling approach which utilises credit ratings from the three main credit rating agencies. Individual and Support Ratings are no longer relevant indicators, and therefore are removed. (Please refer to Appendix D for the Council's Specified and Non-specified Investment Criteria.)

4.1.15 The Council's cash balances for 2015/16 have been as high as £70Million on several occasions and consistently in excess of £60Million. The level of cash balances is high partly due to ring-fenced receipts (New Build), provisions for NNDR appeals and Council Tax surpluses to be redistributed equating to an estimated £18.7Million (or 31% of cash balances) as shown in the table below. This table is illustrative of some of the timing balances the Council currently has which increase cash balances in the short term but are planned to be spent/redistributed in the future. Cash balances are anticipated to significantly reduce over the medium term.

Ring-Fenced Receipts Included in Cash Balances as at 31/12/2015 (£59.87Million)		
	£'Million	**% of investments**
New Build Receipts	11.0	18%
Provision for NNDR appeals	6.0	10%
Council surpluses to be repaid-Ctax	1.7	3%
Total	**18.7**	

4.1.16 During this period of relatively high cash balances it has been difficult to place investments in 2015/16 (and anticipated for 2016/17) and most of the Council's current counterparties are regularly at the maximum £7Million allowed in the Treasury Management strategy limits. The daily cash balances for 2014/15 and 2015/16 are shown in the chart below.



4.1.17 The Council has previously been placing fixed term deposits for 12 months with Local Authorities to alleviate this counterparty pressure. These deposits offered interest rates which were roughly equivalent to those being offered by the market for a six month loan. The Council approved credit criteria for financial institutions limits deposits to six months with financial institutions, and at the time the deposits were placed, the markets were not expecting interest rates to rise for the coming year and therefore the treasury team made prudent use of Local Authorities.

4.1.18 Between 22nd December 2015 and the end of this financial year investments of £13.8Million with Local Authorities will have matured. Capita currently forecast interest rates to increase by December 2016, (previously June 2016). Market rates are currently 1% for a 364 day deals compared to 0.65% for a comparable Local Authority deposit, consequently investments have not been renewed with Local Authorities leading to pressures on counterparty limits.

4.1.19 The Council has a number of options to help alleviate counter party pressure: continue to lend to Local Authorities and reduce the forecast investment rate and/or increase counter party limits.

4.1.20 By increasing counterparty limits, including money market funds from £7Million to £8Million (for balances over £30Million), it is not anticipated this compromises the security of the Council's investment portfolio, as investments are all a minimum of A. This is not to say the Council will not consider investment deals with other Local Authorities but has the flexibility to use existing counterparties.

4.1.21 Furthermore cashflow forecasts do not indicate that cash balances should fall below £30Million in 2016/17 with average balances anticipated to be higher. There is a very small risk that counterparty limits may be breached temporarily should cash balances fall unexpectedly below £30Million, should this occur it would be notified to the Chief Finance Officer and in addition £10Million of investments is always kept in instant access accounts.

4.1.22 The Treasury Management Strategy for 2016/17 makes no change to overnight and instant access deposit holdings, these accounts have the same feature of next day liquidity and therefore subject to the same investment limits. Maximum holding is specified up to 100% of cash holding to reduce liquidity risk.

4.1.23 In order to get the Treasury Management Strategy approved by Council before the start of the financial year, the Chief Finance Officer recommends increasing the counterparty limits, but recognises that a fundamental review of the investment portfolio is required, working with the Council's Treasury Advisors for alternative investment options. The treasury team will also be reviewing other Council's approaches to treasury management. The Audit Committee members will be updated on the team's findings.

4.1.24 The latest list of "Approved Countries for Investments" is detailed in Appendix E). This lists the countries that the Council may invest with, provided they continue to meet the minimum rating of AA-.

4.2 Prudential Code Indicators

4.2.1 The prudential code indicators as shown in Appendix C have been updated for 2016/17 and subsequent years. The 2016/17 **net borrowing requirement** indicator (Appendix C, 3c) is forecast at £173.686Million (2015/16: £170.390Million) which is the total of loans taken less investment held. The detail is shown in the table below.

	2015/16	**2016/17**
	£M	**£M**
Loans HRA	206.415	206.415
Loans General Fund	3.342	3.079
Investments	(39.367)	(35.808)
Total	**170.390**	**173.686**

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 £15.543Million for 2015/16, and £14.889Million for 2016/17 (Appendix C). This indicator shows 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 There is a 2016/17 General Fund budget for interest costs on prior years borrowing (not yet taken) if the circumstances outlined in paragraph 4.1.15 should change. Borrowing requirements or the need for new future borrowing have not changed since the 2015/16 Mid Year Treasury Management Review and therefore no incremental impact on council tax arising from the draft 2016/17 Capital Strategy in 2015/16 and 2016/17 (Appendix C). This is reflective of the use of the capital reserve and capital receipts rather than prudential borrowing to fund the capital strategy.

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 HRA Subsidy CFR of £17.774Million (£17.004Million decent homes external debt and £740,000 internal borrowing) 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 2017 the HRA is forecast to be £9.299Million below its debt cap, (31 March 2016 also £9.299Million below) and would therefore have headroom to take new borrowing. The current HRA Business Plan which is due for revision as a result of changes to the Welfare Reform and Work Bill and the Housing and Planning Bill, makes no assumption about refinancing any of its existing debt. The cost of rescheduling the existing HRA debt is estimated to be a premium of £32Million payable to the PWLB.

4.3.3 All existing HRA debt is projected to be repaid by 28 March 2040 and there are no scheduled repayments of HRA debt in 2016/17 (£5.5Million will be repaid during 2015/16).

4.3.4 The Authorised Limit for borrowing or the limit above which further approval is required from Council is shown in the prudential indicators (Appendix C, 3a). For the HRA this limit must below the Debt Cap of £217.685Million. All planned capital expenditure up to 2018/19 on the HRA is funded from resources available. From 2019/20 the current HRA Business Plan identifies a funding shortfall of £7.952Million which would require borrowing and an increase in the HRA CFR and current projections have identified a significant shortfall in funding within the next 30 years, which officers and members are looking at how this can be addressed.

4.3.5 The HRA CFR indicator (Appendix C, 4), includes the appropriation of land and dwellings and vehicles in 2013/14 and 2014/15 from the General Fund to HRA. These appropriations had due regard to comply with the Council's borrowing limits on external debts. There is likely to be further appropriations from the General Fund to the HRA during 2015/16. At the year end the CFR for both funds will be adjusted for the actual certified value of these assets.

4.3.6 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.

General Fund

4.3.7 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 since 2011/12 onwards.

4.3.8 The Council's General Fund Capital Financing Requirement (Appendix C) is estimated at £15.543Million for 2015/16, and £14.889Million for 2016/17, including the adjustment for appropriation of assets between funds at the estimated value.

4.3.9 The Council had budgeted to take out £1.309Million approved prudential borrowing in 2015/16 (relating to 2014/15). However, due to current cash balances the Council has not been required to take out this physical borrowing. As recommended in the Draft Capital Strategy to the January 2015 Executive the budgeted interest cost which is no longer required in 2015/16 has been transferred to the capital reserve.

4.3.10 The Draft Capital Strategy to the Executive in January 2016 did not include any prudential borrowing in 2016/17.

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 year.

5.2.2 The risk of increasing the counterparty limits form £7Million to £8Million (when investment balances are higher than £30Million is seen as minimal, mitigated by the minimum level of investment grade (A).

5.3 Legal Implications

5.3.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy is 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.

BACKGROUND DOCUMENTS

- BD1 - Annual Treasury Management Review of 2014/15 and Mid-Year Review Report for 2015/16, Council - 9 December 2015 http://www.stevenage.gov.uk/content/committees/139616/139701/139721/153241
- BD2 - HRA budget setting 2016/17 and rent setting – Council 26 January 2016 http://www.stevenage.gov.uk/content/committees/139616/139701/139721/155864
- BD3 - Draft 2016/2017 Council tax setting and General Fund Budget – Executive 19 January 2016 http://www.stevenage.gov.uk/content/committees/139616/139705/139725/155104
- BD4 -2016/17 Draft Capital Forward Plan & 5 Year Capital Strategy Update – Executive 19 January 2016 http://www.stevenage.gov.uk/content/committees/139616/139705/139725/155134

APPENDICES

- Appendix A – Treasury Management Strategy
- Appendix B – Minimum Revenue Provision Policy
- Appendix C – Prudential Indicators

- Appendix D – Specified and Non-Specified Investment Criteria
- Appendix E – Approved Countries for Investment