REDDITCH BOROUGH COUNCIL

EXECUTIVE COMMITTEE

11th March 2014

TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY FOR 2014/15

Relevant Portfolio Holder	Councillor John Fisher
Portfolio Holder Consulted	Yes
Relevant Head of Service	Jayne Pickering, Executive Director, Finance and Resources
Wards Affected	All Wards
Ward Councillor Consulted	N/A
Key Decision	

1. SUMMARY OF PROPOSALS

To enable members of the Executive Committee to scrutinise the Treasury Management Strategy, Prudential Indicators and the Minimum Revenue Provision and approve the Capital Bids.

2. RECOMMENDATIONS

The Executive Committee is asked to RESOLVE that

1) subject to any comments, the Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision Policy for 2014/15, be approved; and

2) the Capital Bids detailed in Appendix A to the report be approved.

3. KEY ISSUES

Treasury Management Operation

3.1 The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA TM Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

3.2 In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

3.3 This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

3.4 The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

3.5 Treasury Management is defined as-

"the management of the local authority's cash flows, its bankings, money market and capital market transactions and loan management; the effective control of the risks associated with those activities; and the pursuit of the optimum performance consistent with those risks".

3.6 The approved activities of the Treasury Management operation are as follows:-

a) Cash flow (daily balances and long term forecasting).
b) Investing surplus funds in Approved Investments.
c) Borrowing to finance cash deficits.
d) Funding of capital expenditure through borrowing, capital receipts, grants or leasing.
e) Management of debt (including rescheduling and monitoring)
f) Interest rate exposure management.
g) Dealing procedures with brokers, banks, building societies and the Public Works Loans Board.

External Context

Economic background

3.7 The Bank of England's Monetary Policy Committee (MPC) through its recent forward guidance is committed to keeping base rates low for an extended period using the Labour Force Survey unemployment rate of 7% as a threshold for when it would consider whether or not to raise interest rates. Unemployment was 7.7% in August 2013, but is not forecast to fall below the threshold until 2016, due to the UK's flexible workforce.

3.8 The flow of credit to households and businesses is slowly improving but is still below pre-crisis levels. The fall in consumer price inflation from the high of 5.2% in September 2011 to 2.0% in December 2013 will allow real wage increases (i.e. after inflation) to slowly turn positive and aid consumer spending.

3.9 Stronger growth data in 2013 (0.4% in Q1, 0.7% in Q2 and 0.8% in Q3) alongside a pick-up in property prices mainly stoked by government initiatives to boost mortgage lending have led markets to price in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. However, with jobs growth picking up slowly, many employees working shorter hours than they would like and benefit cuts set to gather pace, growth is likely to only be gradual.

Credit outlook

3.10 The credit risk of banking failures has diminished, but has not gone away altogether. Regulatory changes are proposed to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process. Diversification of investments between creditworthy counterparties to mitigate risk will become even more important in the light of these developments.

Interest rate forecast

3.11 The bank base rate has remained at 0.5% since 5th March 2009. Forecasts indicate that the Bank Rate will not increase until late 2016, in spite of recent data and market expectations for an increase in Q4 2014.

3.12 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.46%, and that new long-term loans will be borrowed at an average rate of 0.40%.

Local Context

3.13 The Authority currently has £115.4m of borrowing and £3m of investments. Forecast changes in these sums are shown in the balance sheet analysis below.

Table 1: Balance Sheet Summary and Forecast

	31.3.13 Actual £'000	31.3.14 Estimate £'000	31.3.15 Estimate £'000	31.3.16 Estimate £'000	31.3.17 Estimate £'000
General Fund Capital Financing Requirement	16,614	19,129	20,605	20,255	19,844
HRA Capital Financing Requirement (excluding settlement figure)	23,229	23,229	23,229	23,229	23,229
HRA Capital Financing Requirement Settlement	98,929	98,929	98,929	98,929	98,929
Total Capital Financing Requirement	**138,772**	**141,287**	**142,763**	**142,413**	**142,002**
Less external borrowing	121,640	121,640	121,640	121,640	121,640
Internal borrowing	**17,132**	**19,647**	**21,123**	**20,773**	**20,362**
Less: Usable reserves	-19,379	-20,447	-21,222	-22,251	-23,551
Less: Working capital	746	-200	-901	-522	-311
Investments	1,501	1,000	1,000	2,000	3,500

3.14 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.15 The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £0.7m over the forecast period.

3.16 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2014/15.

Borrowing Strategy

3.17 The Authority currently holds £115 million of loans, a decrease of £6 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect make additional external borrowing in 2014/15. The Authority may borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £160 million.

3.18 The Authority'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 Authority's long-term plans change is a secondary objective.

3.19 Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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.

3.20 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 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. In addition, the Authority may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

3.21 The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds
- Internal (capital receipts and revenue balances)

3.22 The Authority has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

Short-term and variable rate loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling

3.23 The PWLB allows authorities 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 redemption terms. The Authority 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.

Investment Strategy

3.24 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £1 and £7 million, and similar levels are expected to be maintained in the forthcoming year.

3.25 Both the CIPFA Code and the CLG Guidance require the Authority 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 Authority's 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.

3.26 The Authority may invest its surplus funds with any of the counterparties in table 2 below, subject to the cash and time limits shown.

Table 2: Approved Investment Counterparties

Counterparty		**Cash limit**	**Time limit**
Banks, Building Societies and other organisations and securities whose lowest published credit rating from Fitch Ratings is:	F1+	£2.5m each	1 year
	F1		1 year
	F2	£0.5m each	3 months
The Authority's current account bank Lloyds plc if it fails to meet the above criteria (reviewed daily)		£2.5m	Next day
UK Central Government (irrespective of credit rating)		unlimited	1 year
UK Local Authorities (irrespective of credit rating)		unlimited	1 year
Other UK public bodies such as Universities		£2.5m each	1 year
"AAA" rated Money market funds		£2.5m each	1 year

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.

Current Bank Account

3.27 The Authority's current accounts are held with Lloyds plc which is currently rated at the F1- rating in table 2. Should the credit ratings fall below F2-, the Authority may continue to deposit surplus cash with Lloyds plc providing that investments can be withdrawn on the next working day, and that the bank maintains a credit rating no lower than F3- (the lowest investment grade rating).

Risk Assessment and Credit Ratings

3.28 The Authority uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investment Services and Standard & Poor's Financial Services to assess the risk of investment default. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria no further investments will be made, any existing investments that can be recalled will be, and full consideration will be given to the recall of all other existing investments with the affected counterparty.

3.29 Where a credit rating agency announces that a rating is on review for possible downgrade so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made until the outcome of the review is announced.

Specified Investments

3.30 The CLG Guidance defines specified investments as those:

- denominated in pounds sterling
- due to be repaid within 12 months of arrangement
- not defined as capital expenditure by legislation
- invested in the UK government, a UK local authority,or a body or investment scheme of "high credit quality".

3.31 The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK.

Non-specified investments

3.32 The Authority does not intend to make any investments not meeting the definition of a specified investment.

Liquidity Management

3.33 The Authority monitors cash flow on a daily basis to determine the maximum period for which funds may prudently be committed.

Treasury Management Indicators

Interest Rate Exposures

3.34 This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as proportion of principal borrowed will be:

	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

Maturity Structure of Borrowing

3.35 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper %	Lower %
Under 12 months	100	0
12 months and within 24 months	100	0
24 months and within 5 years	100	0
5 years and within 10 years	100	0
10 years and above	100	0

Principal Sums Invested for Periods Longer than 364 days

3.36 The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested beyond the period end will be:

	2014/15 £m	2015/16 £m	2016/17 £m
Limit on principal invested beyond year end	0.0	0.0	0.0

Policy on apportioning interest to the HRA

3.37 On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. At that point in time all existing long term loans were attributable to the HRA. In the future, new long-term loans borrowed 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. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured annually and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

Investment Advisers

3.38 The Authority does not have an appointed treasury management adviser. When required specific advice on investment, debt and capital finance issues will be commissioned from appropriately qualified advisers.

Investment Training

3.39 The needs of the Authority's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff attend training courses, seminars and conferences provided by Arlingclose Limited and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

<u>Prudential Indicators</u>

3.40 The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential

Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

3.41 The Authority's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
General Fund	4,273	3,280	1,500	1,500
HRA	8,004	7,552	8,000	8,000
Total Expenditure	**12,227**	**10,832**	**9,500**	**9,500**
Capital Receipts	1,028	1,566	1,500	1,500
Government Grants	309	756	500	500
Reserves	7,559	5,986	6,500	6,500
Revenue	-	-	-	-
Borrowing	3,381	2,524	1,000	1,000
Total Financing	**12,227**	**10,832**	**9,500**	**9,500**

Estimates of Capital Financing Requirement

3.42 The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.14 Revised £m	31.03.15 Estimate £m	31.03.16 Estimate £m	31.03.17 Estimate £m
General Fund	19,129	20,605	20,255	19,844
HRA	23,229	23,229	23,229	23,229
HRA settlement	98,929	98,929	98,929	98,929
Total CFR	**141,287**	**142,763**	**142,413**	**142,002**

3.43 The CFR is forecast to increase by £1m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement

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

Debt	31.03.14 Revised £m	31.03.15 Estimate £m	31.03.16 Estimate £m	31.03.17 Estimate £m
Borrowing	121,640	121,640	121,640	121,640

Total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt

3.45 The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

Operational Boundary	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	150,000	155,000	160,000	165,000

Authorised Limit for External Debt

3.46 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	155,000	160,000	165,000	170,000

Ratio of Financing Costs to Net Revenue Stream

3.47 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income

Ratio of Financing Costs to Net Revenue Stream	2013/14 Revised %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
General Fund	3.7	5.7	8.8	9.2
HRA	39.9	39.4	38.6	37.8

Incremental Impact of Investment Decisions

3.48 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
General Fund- increase in annual band D Council Tax	7.16	12.16	2.43
HRA – increase in average weekly rent	-0.14	0.00	0.00

Adoption of the CIPFA Treasury Management Code

3.49 The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition*.

Annual Minimum Revenue Provision Statement 2014/15 (MRP)

3.50 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

3.51 The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

3.52 The CLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.

3.53 MRP will be determined by charging the expenditure over the expected useful life of the relevant assets in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. *(Option 3 in England and Wales).*

3.54 No MRP will be charged in respect of assets held within the Housing Revenue Account.

3.55 Capital expenditure incurred during 2014/15 will not be subject to a MRP charge until 2015/16

3.56 Based on the Authority's estimate of its Capital Financing Requirement on 31st March 2014, the budget for MRP has been set as follows:

	31.03.2014 Estimated CFR £'000	**2014/15 Estimated MRP £'000**
General Fund assets	**19,129**	**1,048**
Assets in the Housing Revenue Account	23,229	Nil
HRA subsidy reform payment	98,929	Nil
Total Housing Revenue Account	**122,158**	**Nil**
Total	**141,287**	**1,048**

Capital Bids

3.57 There are 3 capital bids detail in Appendix 1, these are essential capital spend.

3.58 There is a bid for £250K per annum for Public Buildings, this is the funding required to maintain our buildings based on the 2009 Condition Survey. There is a detailed plan of works over the next 3 years.

3.59 A further bid for Public Buildings to complete the asbestos management survey and remover where necessary the remaining public buildings that are low risk due to the construction age and adhoc shop units as they become vacant. The cost of this over 3 years totals £80K.

3.60 A bid has also been received for the upgrade to our IT applications and infrastructure to meet the Public Sector Network (PSN) requirements.. This totals £130K over a two year period.

Financial Implications

3.61 The financial implications are contained throughout the report.

Legal Implications

3.62 Under Section 151 of the Local Government Act 1972, the authority has to make arrangements for the proper administration of its financial affairs. The Council has previously resolved to comply with the

Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA TM Code).

3.63 The CIPFA TM Code requires the Authority to approve a treasury management strategy before the start of each financial year.

3.64 In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

3.65 The 2011 CIPFA Prudential Code (as amended 2012) requires the Authority to set prudential indicators.

3.66 This is a statutory report under the Local Government 2003.

Service/Operational Implications

3.67 The Council's policy regarding borrowing and investments is contained in its Treasury Management Strategy.

3.68 This report will determine the Council's policy on making a MRP for 2014/15.

Customer / Equalities and Diversity Implications

3.69 There are no implications identified.

4. RISK MANAGEMENT

4.1 The Council needs to ensure that the risks associated with the treasury function have been properly identified and evaluated. The risks include interest rate exposure, counterparty or credit risk, liquidity (insufficient cash to meet liabilities) risk, funding (inability to repay or replace loans) risk, and the failure of internal controls.

4.2 The Council would be failing in its legal obligations under the Local Government Act 2003 if it failed to agree a set of Prudential Indicators for the forthcoming financial year and if it failed to prepare an annual statement of policy on making a MRP.

AUTHOR OF REPORT

Name: Ian Batchelor Business Support Accountant
E Mail: ian.batchelor@bromsgroveandredditch.gov.uk
Tel: (01527) 64252 ext. 3076