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OXFORD CITY COUNCIL

To:	**City Executive Board** **Council**
Date:	**13th February 2013** **18th February 2013**
Report of:	**Head of Finance**
Title of Report:	**TREASURY MANAGEMENT STRATEGY FOR 2013/14**

Summary and Recommendations

Purpose of report:
To present the Treasury Management Strategy for 2013/14 with the Prudential Indicators for 2013/14 – 2016/17.

Key decision? No

Executive lead member: Councillor Ed Turner

Policy Framework: Sustaining Financial Stability

Recommendation(s): City Executive Board is asked to recommend that Council:

1. Adopt and approve the Prudential Indicators and limits for 2013/14 to 2016/17 as set out in paragraphs 62 - 86 below.
2. Approve the Minimum Revenue Provision (MRP) statement at paragraphs 25 - 27 which sets out the Council's policy on repayment of debt.
3. Approve the Treasury Management Strategy 2013/14, and the treasury prudential indicators at paragraphs 17 – 39,
4. Approve the Investment Strategy for 2013/14 contained in the Treasury Management Strategy, and the detailed investment criteria as set out in paragraphs 40 – 60, and appendix 1 attached.

Appendices:
1 – Specified and Non Specified Investments
2 – Risk Register

Executive Summary

1. The Council's Treasury Management Strategy has been written in accordance with the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. There are no significant changes proposed to our Treasury Management Strategy for 2013/14.

2. The report presents the Council's prudential indicators estimated for 2013/14 – 2016/17. Notable indicators include capital expenditure and borrowing limits, as these are areas of significant activity.

3. Members should note the Minimum Revenue Provision (MRP) policy included at paragraphs 27-31

4. The Council has investments of between £45m and £55m on average at any one time during the year. Investments are made in accordance with the Council's Treasury Management Strategy such that returns are balanced against security of investment, and liquidity of cash to ensure funding of day to day cash flows.

5. The Council's external debt will reduce to £201.3m by the end of March 2013. The majority of debt is held at fixed rates, with varying periods to maturity, £198.5m relates to the Housing Revenue Account and the introduction of HRA self financing on 1/4/2012 which required the Council to make a one-off payment to the Department of Communities and Local Government (CLG) to buy itself out of the previous subsidy system.

6. The Council has one long-term variable rate loan with South Oxfordshire District Council, in respect of debt associated with the boundary change. This will reduce to £0.9m by the end of March 2013.

7. The Council's Capital Programme over the next four years will be funded from a combination of government grants, capital receipts, S106 funding, prudential borrowing and revenue resources. The costs of Prudential borrowing which all relate to the purchase of vehicles are factored into revenue budgets.

Economic Background

8. Although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income and employment fears.

9. The US, faces similar debt problems to the UK and urgently needs to resolve the fiscal cliff now that the presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems (40% of UK exports going to the Eurozone) will depress UK growth and it is possible we will see the UK deficit reduction plans slip beyond 2017.

10. This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk which continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will therefore need to be monitored carefully to minimise the cost of carry - the revenue loss between borrowing costs and investment returns:
- There will be continued difficulties in placing deposits with a limited number of counterparties being active in the market.

Introduction and Background

11. CIPFA defines treasury management as:

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

12. The Local Government Act 2003 (the Act) and supporting regulations require the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

13. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance 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.

14. CIPFA issued revisions to the Prudential Code, Treasury Management Code and Treasury Guidance Notes in mid November 2011. There is little material change in the revisions which are mainly in relation to the Housing Revenue Account. These changes are included within this report and therefore approval of this report adopts these changes.

15. The primary requirements of the Prudential Code are as follows:

    - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by Council of an annual Treasury Management Strategy Statement; including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions to the Council's Section 151 Officer.
- Delegation by the Council of the scrutiny of its treasury management strategy and policies to a specific named body. For this Council the delegated body is the Value and Performance Scrutiny Finance Panel.

16. The Constitution requires the Strategy to be reported to the City Executive Board, Value & Performance Scrutiny and Full Council outlining the expected treasury activity for the forthcoming 4 years on an annual basis. A key requirement of the report is to explain the risks and mitigating actions associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year. Additional quarterly performance reporting is also produced to the Value & Performance Scrutiny Finance Panel.

Treasury Management Strategy

Borrowing and Debt Strategy 2013/14
Prudential Borrowing

17. Under the prudential system, individual authorities are responsible for deciding the level of their borrowing, having regard to CIPFA's code of practice. The system is designed to allow authorities that need, and can afford to, to borrow in order to pay for capital investment.

18. The key objective of the Prudential Code is to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable.

19. The prudential system provides a flexible framework within which capital assets can be procured, managed, maintained and developed. At a strategic level it allows authorities to make their own decisions about the balance to be struck between revenue intensive or capital intensive methods of procuring services. As a consequence these arrangements permit 'invest to save' schemes to proceed where they are not only affordable but also prudent and sustainable.

20. Any prudential borrowing undertaken affects the Council's prudential indicators, and when deciding on our levels of prudential borrowing the Council must have regard to:
    - Affordability e.g.: implications for Council Tax and rent levels
    - Prudence and Sustainability e.g.: implications of external borrowing
    - Value for money
    - Stewardship of assets
    - Service Objectives e.g.: strategic planning for the authority
    - Practicality

21. A fundamental aspect of the prudential system is the ability of each local authority to determine locally the need for capital investment against the option of revenue funding. Financial planning has to take into account the range of options for revenue funding and capital investment by:

    - Establishing whether the authority considers it is affordable and prudent to bear the additional future revenue cost associated with additional investment, e.g.: financing and running costs
    - Establishing whether the use of existing or new resources to finance capital investment should have precedence over other competing needs
    - Establishing the scope for capital investment to generate future revenue savings or income, taking into account the risks associated with such proposals.

22. The maximum level of prudential borrowing is a matter for the Council to determine. The parameters according to legislation and the prudential framework are:
    - That the Council must set a balanced revenue budget that includes the revenue consequences of any capital financing i.e. the revenue budget needs to be able to cover the interest and debt repayment of any borrowing' as well as the running costs of the new project
    - That the authorised borrowing limit that the Council sets must ensure that borrowing to fund capital projects is reasonable and that the impact on Council Tax or council rents is reasonable.

23. Unlike in other sectors where gearing ratios are used to benchmark borrowing levels, there is no mathematical calculation for local authorities to arrive at a limit. Each council must therefore take account of its local circumstances in determining its borrowing level.

24. The Capital Programme includes approximately £4.3m of General Fund prudential borrowing for the purchase of vehicles during the period 2013/14 - 2016/17. The revenue impact of this borrowing is estimated at around £600k per annum and is factored into the Medium Term Financial Plan.

Minimum Revenue Provision (MRP) Statement 2013/14

25. The Council is required to pay off an element of its accumulated General Fund borrowing each year (the Capital Financing Requirement – CFR) through a revenue charge, this is the Minimum Revenue Provision (MRP). Additional voluntary payments can also be made if required (Voluntary Revenue Provision (VRP)).

26. Regulations require full Council to approve an MRP statement in advance of each year. The Council is recommended to approve the following MRP statement:

    a) For Capital expenditure incurred before 1st April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

       Existing practice – MRP will follow the existing practice outlined in former CLG regulations

    b) For all unsupported borrowing incurred after1st April 2008 the MRP policy will be:

       Asset life method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations

Table 1:- Estimated General Fund MRP 2012/13 – 2015/16

	2012/13	2013/14	2014/15	2015/16
Vehicles	1,271,323.33	882,092.87	636,896.71	477,466.87
Playparks	135,523.02	135,523.02	135,523.02	135,523.02
	1,406,846.35	**1,017,615.89**	**772,419.74**	**612,989.89**

27. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. Regulations will allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years of the HRA reform scheme. Depreciation on the HRA properties is estimated to be £6.5m per annum over the four year period.

28. The S151 Officer has delegated powers to determine the need for any future borrowing taking into account the prevailing interest rates and associated risks. A combination of long-term and short-term fixed and variable rate borrowing may be considered. This may include borrowing in advance of future years' requirements.

29. Where there is a clear business case for doing so borrowing may be undertaken to fund the approved Capital Programme or to fund future debt maturities. The S151 Officer will adopt a cautious approach to any such borrowing.

30. In determining whether borrowing will be undertaken in advance of need the S151 Officer will:

- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- Consider the pros and cons of alternative forms of funding
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- Consider the impact of borrowing in advance on investment cash balances and the consequent increase in exposure to counterparty risk, and other risk, and the level of such risks given the controls in place to minimise them.

31. In undertaking borrowing, the Council will consider all options open to us, which include borrowing from banks or building societies, other local authorities and the Public Works Loan Board (PWLB) which is a Government department and provides loans to local authorities.

32. The option of postponing borrowing and running down investment balances known as internal borrowing will also be considered. This is a practice the Council has followed in previous years and reduces counterparty risk and mitigates against the difference in interest payable on borrowing and that earnt on investments. To do this requires a clear understanding of the cashflow requirements of the organisation to ensure a sufficient flow of funds to meet liquidity needs.

33. Council officers, in conjunction with our treasury advisors, Sector, will continually monitor both the prevailing interest rates and the market forecasts, thereby allowing us to respond to any changes such that:

- If market conditions indicated a likelihood of a significant risk of a sharp fall in long and short term rates, any long term borrowing being considered would be postponed

- If market conditions indicated a likelihood of a significant risk of a sharp rise in interest rates any borrowing being considered would be locked in at long term fixed rates

34. The Council had approx £202.2m of external debt with PWLB as at 1st April 2012, all of which is held at fixed rates, with varying maturity terms up to 2057. The debt is wholly related to Housing.

35. During 2012/13 repayments will reduce this debt figure outstanding to approx £201.3m.

36. The Council also has £1.2m of long-term liabilities; this is an outstanding debt with South Oxfordshire District Council and is held at a variable rate, and will reduce to £0.9m by the end of March 2013.

37. The Council's Capital Financing Requirement (CFR, the underlying need to finance capital expenditure) as at 1st April 2012 was £221.206m which is above the level of external borrowing, of £202.3m and an indication of the Council's underlying need to borrow to fund its capital investments (£18.9m). This has been met by internal borrowing.

38. As at the 31st March 2013 the General Fund CFR is expected to be £235k and the HRA CFR is expected to be £222m, with external borrowing of £202.3m. This indicates a potential need to borrow on the external market in the medium term, if all schemes in the proposed Capital Programme go ahead.

39. In summary there are no changes to the Councils borrowing strategy for 2013/14.

Investment Strategy 2013/14

Interest Rates

40. With average cash balances fluctuating between £45 million and £55 million at any one time investment interest rates are important to the Council. Deposits are made at or close to prevailing interest rates.

41. Interest rates are currently at an all time low, with Base Rate at 0.50%. It has been at this level since March 2009 and is forecast by a number of financial advisors including the Council's Treasury Management advisors, Sector Treasury Management Services Ltd; to remain at this level until at least December 2014 and then slowly begin to rise thereafter.

Sector's Bank Base Rate Forecasts for financial year ends March 31st

- 2012/ 2013 0.50%
- 2013/ 2014 0.50%
- 2014/ 2015 0.75%
- 2015/2016 1.75%

42. The Council will generally avoid locking into longer term deals (over 364 days) while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by Council.

42 The primary principle governing the Council's Investment Strategy is the security of its investments; however yield or return on investment and liquidity are also key issues. Consequently, procedures determining the maximum periods funds may be invested for as well as the nature of those funds/ investment types are regularly reviewed.

43 The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

44 Investment instruments identified for use are listed in Appendix 1 under the Specified and Non-Specified investment categories. Counterparty limits are set in accordance with the Council's Treasury Management Practices (TMP's).

Creditworthiness Policy

45 The Council utilises the creditworthiness service provided by Sector. The model combines the credit ratings, credit watches and credit outlooks from all three credit agencies – Fitch, Moody's and Standard and Poors in a weighted scoring system which is then combined with an overlay of Credit Default Swap spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration of investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

46 Sector refresh their model on a weekly basis. The Council use counterparties within the following durational bands:

- Purple 2 years (none)
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks eg Lloyds TSB, Bank of Scotland, Royal Bank of Scotland and Natwest)
- Orange 1 year (none)
- Red 6 months (none)
- Green 3 months (E.g. Bank of New York Mellon; Credit Suisse International; HSBC; Standard Charter and Nationwide BS)

47 The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- if a counterparty's credit rating is placed on negative watch or negative outlook then officers will carry out a review to determine whether the institution is still worthy of inclusion on the Council's treasury management lending list. If there is any doubt then the institution will be temporarily suspended pending the credit rating agency's full review.

- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis.

In addition to the Sector service the Council also use market data and market information, information on government support for banks and the credit rating of that government support to inform its investment decisions.

48 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide

49 For operational purposes the Council's counterparty list will be reviewed on a daily basis taking into account market information and changes to the criteria provided. This list will be maintained by the Treasury team, and reported to the Section 151 Officer on a regular basis.

50 Within the agreed Investment Strategy the S151 Officer has delegated powers to undertake the most appropriate form of investments depending on the prevailing interest rates and security of counterparty at the time.

51 The Council also retain the option to place deposits with the top five Building Societies by asset base size, which is a deviation from Sector's Criteria. Only the Building Societies with an asset base of £9bn or above will be included on the treasury management lending list. Lending to those societies who do not currently satisfy Sector's minimum credit rating criteria will be restricted to a maximum term of 3 months and no more than 20% of the total investment portfolio or a maximum limit of £3m with any one counterparty.

52 There are currently five Building Societies which have an asset base of over £9bn as shown below:

Building Society	**Asset Base***	**Year End**
Nationwide	£194,988m	4th April 2012
Yorkshire	£33,177m	31st December 2011
Coventry	£28,848m	31st December 2011
Skipton	£13,849m	31st December 2011
Leeds	£9,829m	31st December 2011

* Figures provided by the Building Societies Association as at each societies year end

53 Limits have also been placed on countries and sectors, as follows:
- No more than 20% of the previous year's average monthly investment balance with any one counterparty or group (currently £6.8m)

- No limit for UK investments
- Maximum 10% of total investments to be with institutions in other countries that meet the current criteria

54 The Council's bankers are the Co-operative Bank. The credit ratings for this bank do not currently meet the criteria set above. Therefore the Council are only using the Co-operative for transactional purposes and overnight investments for up to £500k. This is intended to limit the Council's risk but still allow us to utilise the services provided by our house bank. In exceptional circumstances and with approval of the Council's Section 151 Officer, this limit may be exceeded for a period of up to 2 weeks.

Specified and Non Specified Investments

55 In approving the overall investment strategy Members are requested to approve the types of investments that are used. These investments are broken down into Specified and Non Specified investments and are shown in more detail in Appendix 1

56 **A Specified investment** is one that is in Sterling, is not more than 1 year from inception to repayment, or which could be for a longer period but where the Council has the right to be repaid within that period if it wished. **Non specified investments** are any other type of investment; these also include the non- rated building societies included on our counterparty list. Since non-specified investments are inherently more risky in nature in a change to previous strategies it is recommended that a level of no more than 25% of the portfolio will be held with such counterparties.

57 Whilst in the normal course of the Council's cash flow operations it is expected that both Specified and Non-specified investments will be used in Treasury Management Operations, generally, with the exception of non-rated building societies investments, officers have restricted their dealings to specified investments. Additionally Council officers have also tended to work with UK institutions only although the Strategy permits the use of any bank that meets the minimum criteria.

58 However, with surplus cash balances expected to increase over the medium term to well over £50 million, mainly arising from HRA self-financing, the use of non-specified investments, included in the current Strategy may be the subject of consideration together with a number of other investment opportunities. These are highlighted below :

a. **The use of longer-term instruments** (greater than one year from inception to repayment). These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the investment prudential indicator shown in paragraph 84.
b. **Property Funds**, these are an instrument that the Council has not used to date, but in light of the increase in investment balances and

current counterparty rates warrant further investigation. A detailed review of these funds will be undertaken with our Treasury advisors Sector to ensure all risks and rewards are considered prior to their being used. Returns vary across the 50 property funds that Sector have data on and range from -1.78% to 18.03% over the last 3 years.

c. **Payden & Rygel is a sterling reserve fund**, which is a bond fund rather than a money market fund. This predominantly invests in a diversified portfolio of high-quality, sterling-denominated securities including gilts, supranationals, agencies and corporate bonds.
   The fund is AAA bond rated from S&P, but has a greater volatility than MMFs as it is not a fixed rate purchase. (VNAV (variable net asset value) with a longer WAM (weighted time to average maturity), and provides and alternative investment tool. This fund is not recommended for short term investments, and our advisors have suggested a minimum of 6 months, however this is an instant access fund.
   In Sector's view the fund is broadly diversified, so it is limiting credit risk, in addition it offers access to sectors not traditionally available for direct investment.
d. **External fund manager**. These managers aim to achieve long-term outperformance by actively managing the cash and taking advantage of market inefficiencies, whilst at the same time bearing in mind the preservation of capital.
   Typically in a rising interest rate environment, the fund manager is should be able to perform better as there are more opportunities in trading in the gilt market. If the Council were to consider placing some core cash with an external fund manager we would consider the options in conjunction with our advisors.
e. **Investment property purchases**. The Council can also consider purchasing additional investment properties to be included within the Councils investment property portfolio. The current portfolio of £86m makes approximately £6 million per annum. These properties would not directly form part of the Treasury Strategy but would provide a rate of return to the council, and would be considered if a reasonable rate were achievable. Any prospective purchases would utilise the surplus core cash and would be subject to a robust business case through the Councils capital strategy.

59 All of these additional investment options will assist the Council over the medium term as the cash balances are expected to rise following the HRA reform, and ahead of the expected increase in capital expenditure on the improvement of existing homes, building new homes and purchase of other properties.

60 In summary whilst officers will look to make use of a number of different opportunities in which to investment these are included either within the current list of approved investments or, in the case of investment property opportunities will be the subject of a separate business case presented to Members at a future date. The only recommended change to the existing

strategy is the imposition of a 25% limit on the maximum amount of non-specified investments based on the total investment portfolio.

Icelandic Bank Investments

61 The Council placed deposits with two Icelandic banks prior to their collapse in 2009, original balances were £3m with Heritable and £1.5m with Glitnir. Heritable have repaid 75% of the initial deposit plus interest and continue to make repayments. It is still expected that we will receive up to 90% back. The Council have also received over 80% of the original deposit with Glitnir, the remaining balance is still owing but is expected to be received in its entirety, however it may be subject to an element of exchange rate loss.

Prudential Indicators

A. Capital Expenditure Plans

62 The Council's capital expenditure plans are the key driver of treasury management activity. Estimates of capital expenditure for the period 2013/14 to 2016/17 are summarised below and this forms the first of the prudential indicators. The revenue consequences of associated borrowing and any ongoing maintenance costs are accommodated within the Council's revenue budgets.

63 Capital expenditure can be paid for immediately, by applying capital resources such as capital receipts, capital grants, external funding or revenue contributions, but if these resources are insufficient any residual expenditure will add to the Council's borrowing need, or Capital Financing Requirement (CFR).

64 Estimates of resources such as capital receipts may be subject to uncertainty i.e. anticipated asset sales may be postponed or reduced due to the property market or planning issues.

65 Elsewhere on the agenda the proposed Capital Programme is recommended for approval, a summary of these figures are in the table below and form the first prudential indicator:

Table 2:- Capital Expenditure

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
General Fund	16,895.0	11,341.5	21,130.3	9,906.1	4,636.0	3,182.0
HRA	8,535.0	8,342.5	19,054.0	21,247.0	14,310.0	22,360.0
	25,430.0	19,684.0	40,184.3	31,153.1	18,946.0	25,542.0

66 The next table summarises the above capital expenditure plans and how they will be financed. Any shortfall of financing results in a borrowing need.

Table 3:-Capital Expenditure and Financing

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Expenditure						
General Fund	16,895.0	11,341.5	21,130.3	9,906.1	4,636.0	3,182.0
HRA	8,535.0	8,342.5	19,054.0	21,247.0	14,310.0	22,360.0
Total expenditure	**25,430.0**	**19,684.0**	**40,184.3**	**31,153.1**	**18,946.0**	**25,542.0**
Financed by:						
Developer Contributions	0.0	706.9	755.9	1,058.8	0.0	0.0
Captial Grants	8,985.0	9,253.3	740.0	2,415.0	390.0	540.0
Captial Receipts	4,814.7	3,874.9	14,675.2	5,255.2	1,046.9	332.4
Revenue	4,057.5	4,217.5	22,605.7	20,944.8	16,139.1	24,216.6
Prudential Borrowing (Vehicles)	1,291.0	1,631.5	1,407.5	1,479.3	1,370.0	453.0
Total funding	**19,148.2**	**19,684.0**	**40,184.2**	**31,153.1**	**18,946.0**	**25,542.0**
Net financing need for the year	**6,281.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Note: the original capital budget for 2012/13 assumed a level of prudential borrowing the majority of which would be undertaken for the construction of the Competition Swimming Pool. The latest revision of the Capital Plan has removed this and assumes that this expenditure will be financed from capital receipts. This is alos reflected in the movement in Table 4 below.

a. **Capital Financing Requirement (CFR).**

67 The CFR is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow. Prudential borrowing is explored in more detail below.

68 The CFR includes any other long term liabilities (eg finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

Table 4:- Capital Financing Requirement

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
General Fund	7,956	235	1,324	2,471	3,509	3,680
HRA	223,380	222,297	222,297	222,297	222,297	222,297
	231,336	222,532	223,621	224,768	225,806	225,977
Movement in CFR	5,976	-2,828	1,089	1,147	1,038	171

69 The Strategy also includes the Prudential Indicators, which the authority is required to consider before determining its budget and treasury management arrangements for the new financial year. These indicators are a statutory requirement and therefore have to be reported to Council each year. These indicators are split into two categories the first is affordability. Our affordability indicators are listed below:

C. Ratio of financing costs to the net revenue stream

70 The estimate of the ratio of financing costs to the net revenue stream, which is the net budget requirement as shown in the budget papers, this is shown below, this identifies the trend in the cost of capital against the net revenue stream and shows GF and HRA separately.

Table 5:- Ratio of financing costs to net revenue stream

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
General Fund	2.1%	13.4%	13.0%	11.9%	11.8%	11.0%
Housing Revenue Account	19.3%	17.2%	16.1%	14.5%	12.8%	12.2%

D. Incremental impact of capital investment decisions on Council Tax and Rents

Council Tax

71 The estimate of the incremental impact of capital investment decisions on the Council Tax is shown below; this shows the impact of any decisions that are made on investment through the Capital Programme and how this will ultimately affects the Band D Council Tax.

72 The figures in the table below have been calculated by looking at those schemes that are currently uncommitted in the current Capital Programme and looking at the impact they will have on Council Tax after taking into account capital receipts and revenue contributions.

73 The Council will not enter into any uncommitted capital scheme until the source of funding is confirmed, e.g. Capital receipts, grants, S106 or prudential borrowing. This will ensure we can avoid any unplanned revenue consequences as a result of capital expenditure.

74 . The following table shows the impact on Council Tax of the revenue funding for the Capital Programme.

Table 6:- Impact of Capital Expenditure on Council Tax

	2012/13 Original Estimate £	2012/13 Revised Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
Overall net impact on Council Tax Band D	0.23	0.26	0.49	0.23	0.11	0.07

Housing Rents

75 The estimated incremental impact of capital investment decisions on weekly housing rents is shown below. The figures have been calculated by looking at those schemes that are currently in the Capital Programme and deducting alternate funding resources.

76 The key drivers for setting our housing rents with effect from 1st April 2013 will be affordability and the need to cover net expenditure (including the take on of the buy out debt). Formula rent guidance continues at inflation plus 0.5% until full rent conversion is reached.

77 Since all the HRA Capital Programme is financed from revenue the effect on council rents is as follows:

Table 7:- Impact of Capital Expenditure on Housing Rents

	2012/13 Original Estimate £	2012/13 Revised Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
Overall net impact on Weekly Housing Rents	1.05	1.03	2.34	2.61	1.76	2.75

78 Dwelling rents are increased in line with Government rent restructuring policy. The value of a property influences the individual level of rent charged.

E. Authorised limit for external debt

79 This represents a limit beyond which external debt is prohibited. It reflects the level of external debt, which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Table 8:- Authorised Limit for external debt

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
General Fund	8,000	6,000	5,000	4,000	2,000	2,000
HRA	243,000	243,000	243,000	243,000	243,000	243,000
Other Long Term Liabilities	1,500	1,500	1,000	750	0	0
Total	252,500	250,500	249,000	247,750	245,000	245,000

80 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is:

HRA Debt Limit	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Total	242,199	242,199	242,199	242,199	242,199

F. Operational boundary for external debt

81 This is based on the expected maximum external debt during the course of the year, it is not a limit, and actual external debt can vary around this boundary for short times during the year.

Table 9:- Operational boundary for external debt

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Borrowing	8,000	4,000	3,000	2,000	0	0
Additional HRA Settlement	234,000	234,000	234,000	234,000	234,000	234,000
Other Long Term Liabilities	1,500	1,500	1,000	750	0	0
Total	243,500	239,500	238,000	236,750	234,000	234,000

G. Net Borrowing Compared to the Council's Capital Financing Requirement

82 The table below shows the Council's net borrowing position compared to its Capital Financing Requirement. As can be seen, the figures show that the Council is currently borrowing below its financing requirement which indicates a need to borrow in the short to medium term. The Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 10:- Net borrowing compared to CFR

	2012/13 Original Estimate £000's	2012/13 Revised Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's	2016/17 Estimate £000's
Gross Borrowing	223,380	201,368	200,638	199,908	198,528	198,528
Other Long Term Liabilities	1,200	889	607	311	101	0
Total Gross Debt 31 March	**224,580**	**202,257**	**201,245**	**200,219**	**198,629**	**198,528**
CFR	231,336	222,532	223,621	224,768	225,806	225,977
Net Borrowing v CFR	**6,756**	**20,275**	**22,376**	**24,549**	**27,177**	**27,449**

H. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Sector

83 The Council can confirm that it has complied with this code throughout 2012/13 and will continue to do so.

I. Upper limit on fixed and variable interest rate borrowing and investments

84 The purpose of this and the following two prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. This indicator identifies the maximum limit for fixed interest rates based upon the debt position net of investments.

Table 11:- Upper limit on borrowing and investments

	2012/13 Original Estimate %	2012/13 Revised Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
Upper limit on fixed rate borrowing	100	100	100	100	100	100
Upper limit on fixed rate investments	100	100	100	100	100	100
Upper limit on variable rate borrowing	100	100	100	100	100	100
Upper limit on variable rate investments	100	100	100	100	100	100

J. Upper and Lower limit for the maturity structure of borrowing

85 These are used to reduce the Council's exposure to large fixed rate sums falling due for repayment at the same time.

Table 12:- Upper and lower limit on borrowing maturity

	2013/14 Estimate Upper %	2013/14 Estimate Lower %	2014/15 Estimate Upper %	2014/15 Estimate Lower %	2015/16 Estimate Upper %	2015/16 Estimate Lower %	2016/17 Estimate Upper %	2016/17 Estimate Lower %
Under 12 months	30	0	30	0	30	0	30	0
12 months to 2 years	30	0	30	0	30	0	30	0
2 years to 5 years	80	0	80	0	80	0	80	0
5 years to 10 years	100	0	100	0	100	0	100	0
10 year and above	100	0	100	0	100	0	100	0

86 Upper limit for principle sums invested for periods longer than 364 days, this indicator is used to reduce the need for early sale of an investment, and is based on the availability of funds after each year end. This has been set at zero due to the uncertainty of the market and reducing our risk of longer term investments.

Table 13:- Upper limit for investments longer than 364 days

	2012/13 Original Estimate %	2012/13 Revised Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %	2015/16 Estimate %
upper limit for investments for periods longer than 364 days	0	0	20	20	20	20

Legal Implications

87 This report fulfils four key legislative requirements:

- The reporting of the prudential indicators setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice

- Agreeing the Council's Minimum Revenue Provision (MRP) policy, which sets out how the Council will pay for capital assets through revenue each year (as required by Guidance under the Local Government and Public Involvement in Health Act 2007)

- Agreeing the treasury management strategy, which sets out how the Council's treasury service will support the capital decisions taken, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing limit required by S3 of the Local Government Act 2003. This is in accordance with the CIPFA code of Practice on Treasury Management and the CIPFA Prudential Code

- Agreeing the investment strategy, which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG investment guidance.

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Appendix 1
Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Section 151 Officer has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.

3. A local authority, parish council, community council, Fire or Police Authority
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society) meeting the minimum 'high' quality criteria where applicable.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is:

	Minimum credit criteria/colour banding	**Max % of total investments /£ limit per institution**	**Max maturity period**
DMADF – UK Government	Not applicable	100%	12 months
UK Government Gilts	UK Sovereign rating	20%	12 months
UK Government Treasury Bills	UK Sovereign rating	20%	12 months
Bonds issued by multilateral development banks	UK Sovereign rating	20%	6 months
Money Market Fund	AAA	100%	liquid
Local Authorities, Fire and Police authorities		100%	12 months
Term deposits with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£10m or 20% of total investments	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
CDs or corporate bonds with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£10m or 20% of total investments	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
Enhanced Cash funds		20%	6 months
Corporate bond funds		20%	6 months

Gilt Funds	UK sovereign rating	20%	6 months

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Overall non specified investments will not exceed more than 20% of the investment portfolio. As the Councils average investment balance increases over the medium term decisions will need to be made on the viability of undertaking additional non specified investments. Non specified investments would include any sterling investments with:

	Minimum Credit Criteria	**Max % of total investments/£ limit per institution**	**Max maturity period**
Fixed term deposits with variable rate and variable maturities	Orange	10% of total investments	Upto 1 year
Fixed term deposits with variable rate and variable maturities	Yellow Purple	£10m or 20% of total investments	Up to 5 years Up to 2 years
Fixed term deposits with unrated Building Societies	Asset Base over £9bn	£3m – 20% of total investments	3 months
Commercial paper issuance covered by a specific UK Government (explicit) guarantee		10% of total investments	Upto 1 year
Commercial paper other		10% of total investments	Upto 1 year
Corporate bonds		10% of total investments	Upto 1 year
Other debt issuance by UK banks covered by UK Government (explicit) guarantee		10% of total investments	Upto 1 year
Floating rate notes		10% of total investments	Upto 1 year
Property fund		10% of total investments	Upto 1 year

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector on a weekly basis, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Finance, and if required new counterparties which meet the criteria will be added to the list.

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