Report of the Director of Policy and Resources

Agenda Item No:
Meeting: 19 February 2013

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

TREASURY MANAGEMENT STRATEGY REPORT 2013/14

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1 This report proposes a Treasury Management and Investment Strategy for 2013/14. It has been prepared in line with

- The CIPFA Code of Practice for Treasury Management
- The Prudential Code
- The Local Government Finance Act 2003
- Investment guidance from the Department for Communities and Local Government (CLG)

1.2 The **investment strategy for 2013/2014** aims to reduce risk by

- Investing for shorter periods up to six months
- Only investing directly in UK institutions with a minimum of an adequate credit rating or equivalent
- Applying a maximum investment limit of £5m for most counter-parties
- Applying a maximum limit to financial groups rather than separate institutions
- Investing in a wider range of institutions through a Money Market Fund.

1.3 The **borrowing strategy for 2013/2014** aims to

- Suspend borrowing in the plan period for as long as is prudent
- Track the differential between short-and long-term interest rates to determine when it is prudent to resume borrowing
- Borrow only to support the capital programme
- Maximise borrowing through the PWLB while this gives best value for money
- Borrow for shorter periods if cash flow requires and
- Consider debt rescheduling.

2. BACKGROUND INFORMATION

THE LEGAL FRAMEWORK

2.1 CIPFA introduced a revised Code of Practice for Treasury Management in December 2011. A revised Prudential Code for Capital Finance in Local Authorities has been issued but may be modified following further consultation.

Code of Practice for Treasury Management

2.2 The Code has been reviewed and updated following the scrutiny of the investment practices of local authorities in the aftermath of the Icelandic banking failure.

2.3 CIPFA revised its definition of Treasury Management to emphasize the management of risk. It is CIPFA's view that throughout the public service the priority is to protect capital rather than to maximise return. The avoidance of all risk is not appropriate or possible, but care must be exercised in the management of public money.

The Prudential Code

2.4 This Code governs councils' borrowing in particular for capital investment. It has been revised following a consultation process and taking into account the implementation of International Financial Reporting Standards (IFRS) since 2010/11. The key changes are an increased emphasis on capital planning and asset management and a number of revised definitions.

2.5 There are reminders (as with the Treasury Code) that local authorities' prime policy objectives of their investment activity are security and liquidity of funds, and that they should avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider the return on their investments but not at the expense of security and liquidity.

2.6 Authorities should also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds.

THE ECONOMIC CONTEXT

2.7 ***Short-term interest rates*** are expected to remain at current rates for some time. The Office for Budgetary Responsibility assumes that base rates are held at 0.5% in 2013 rising to 0.7% the end of 2014 and 1.3% by the end of 2015. Some analysts are predicting a cut in the base rate to 0.25% in 2013. The Consumer Price Index (CPI) has been falling but remains above the Bank of England's 2% target. The CPI measure of annual inflation was 2.7% at December 2012 down from 4.2% in 2011. The Bank of England Inflation Report November 2012 forecasts Inflation at around the 2% level for 2013.

2.8 A key consideration is ***growth in GDP.*** Appendix A shows the latest projections from the Office of Budget Responsibility. They show a forecast reduction in 2012 with growth returning in 2013.

2.9 ***Sovereign debt levels*** continue to cause concern for investors. Despite support from the European Central Bank several Eurozone economies are still vulnerable and the failure of one of the weaker economies could still cause contagion to spread across Europe potentially causing a breakup of the Euro. Of the Eurozone members only Germany, Luxembourg and the Netherlands still have a AAA credit rating. The UK has been put on negative watch by two of the three credit rating agencies, meaning there is a danger the UK will lose its AAA rating within the next two years.

2.10 There continues to be uncertainty about the ***resilience of banks*** in Europe and in the UK. Whilst banks and other institutions are stronger than in 2008 there are still concerns about the strength of many banks.

2.11 Several Banks and other Financial Institutions have had their credit ratings downgraded or placed 'on negative watch' in the past year.

2.12 Given the uncertainties surrounding the UK economic outlook, in terms of economic growth and the ability of banks to finance it, the council's budget takes a prudent view by building in short-term interest rates of 0.5% in the plan period.

2.13 **Longer-term interest rates** have fluctuated since April 2010 with 25 year PWLB loans ranging between the current rate of 3.95% and 5.48%. Long-term fixed interest rates are affected by the performance of the UK economy, Quantitative Easing, inflation expectations, gilt issuance, sovereign debt ratings and ratings risk.

2.14 The role of the PWLB is to on-lend central government's own borrowing to local authorities to deliver capital investment, while HM Treasury is responsible for determining the methodology used to set the rates at which PWLB transacts.

2.15 The Government recognises that local authority decisions on borrowing can commit electors to repaying loans for up to 50 years (for North Lincolnshire 25 years has been the benchmark limit).The PWLB therefore plans to publish on its website a monthly list of individual local authority loans to make borrowing decisions public and transparent. The council has qualified to receive PWLB loans at a discounted rate, known as the Certainty rate. Where possible any borrowing will use this rate. Current indicative rates are at historically low levels:

Maturity loans have equal payments of interest each year with full repayment of the principal in the final year.

- 25 year maturity 4.23% (4.03% Certainty rate)
- 10 year maturity 3.06% (2.86% Certainty rate)

EIP (equal instalments of principal) loans have equal repayments of principal each year with interest paid on the reducing balance.

- 25 year EIP 3.43% (3.23% Certainty rate)
- 10 year EIP 2.10% (1.90% Certainty rate)

Annuity loans have equal payments each year with the proportion of interest and principal shifting over time from being predominantly interest to being predominantly principal.

- 25 year annuity 3.58% (3.38% Certainty rate)
- 10 year annuity 2.12% (1.92% Certainty rate)

2.16 Currently a majority of the council's loans are of the maturity type with some EIP. It is proposed that annuity loans are considered due to their lower cost and the spreading of the principal repayments over the life of the loan.

THE CURRENT PORTFOLIO POSITION

Investments

2.17 The council generally runs a cash surplus. The balance varies as grant, business rates and council tax are received, and payments and transfers are made. The surplus also includes reserve/fund balances.

2.18 Investments change on a daily basis. So far in 2012/13 the council has invested on average £37.3m (compared to £35m in 2011/12). The minimum amount invested was £9.1m and the maximum amount invested was £47.4m at interest rates averaging 0.6% compared to base rate 0.5%. Estimated cash flows for 2012/2013 are expected to give an average daily balance of £30.6m.

2.19 Cash balances available for investment are as above less the £1.85m currently deposited with Icelandic banks which are in receivership or administration.

2.20 The council has taken steps to recover investments with Icelandic banks in concert with other local authorities acting through the Local Government Association. The administration of Heritable is progressing well. The latest advice is to expect a return of 85 pence in the pound. The council's preferential creditor status with Landsbanki means that a return of the entire investment is expected.

Institution	Claim	Paid	Estimated Recovery
Heritable	£3.52m	£2.70m	£2.99m
Landsbanki	£2.26m	£0.94m	£2.26m

Dividends from both institutions continue to be paid and it is estimated that 90% of the amount claimed will ultimately be recovered.

Borrowing

2.21 The councils' standard policy has been to borrow to meet the costs of capital investment which cannot be funded from alternative sources, with the facility to borrow short-term for cashflow purposes if necessary.

2.22 For the past five years it has not borrowed new funds because of the underlying cash surplus. While a significant differential between long and short term interest rates persists this remains a rational approach.

3. OPTIONS FOR CONSIDERATION

3.1 The council has a range of options when determining its ***strategy for investment***. This includes the type of investments it will make, with which institutions and for what term. It must do so within the framework of government legislation which sets limits on the range of investments which can be made, while following the best practice requirements of the Treasury Code of Practice. A key consideration is to determine the portfolio of investments which will be used: to spread risk, maintain flexibility to meet obligations to creditors, and maximise return whilst maintaining capital security at all times.

3.2 A similar range of considerations apply to the ***borrowing strategy***. In framing its borrowing policy the council must follow the requirements of the Prudential Code and related guidance issued under the Local Government Act 2003. A key priority is to minimise the cost of borrowing and this will dictate the choice of counterparties, financial instruments and the term of any loan. Generally the council borrows only to meet the cost of its capital programme, although it needs the facility to borrow short-term if cash flows demand (typically at year end).

4. ANALYSIS OF OPTIONS

INVESTMENT STRATEGY

Investment Options

4.1 Specified investments. Following guidance issued under s15 (1) (a) of the Local Government Act 2003 these are investments offering high security and high liquidity. An investment is a specified investment if all of the following apply;

(a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
(b) the investment is not a long-term investment i.e.it has a maturity of no more than 12 months;
(c) it does not involve the acquisition of share capital or loan capital in any body corporate;
(d) the investment is made with a body or in an investment scheme which has been awarded a high credit quality (see para. 4.7) by a credit agency or is made with:
  (i) the United Kingdom Government
  (ii) a local authority in England or Wales or similar body in Scotland or Northern Ireland
  (iii) a parish council or community council.

It is recommended that specified investments should continue to be the focus for council investment.

4.2 **Non-specified investments**. These are investments which, by definition, do not meet the conditions laid down as specified investments, and potentially carry additional risk, e.g. lending for periods beyond 12 months or to bodies which are not highly credit rated. In the current volatile financial markets it is recommended that lending beyond 12 months is **not** considered except for the Local Lend a Hand scheme.

Consideration is being given to joining the Lloyds Banking Group's Local Lend a Hand Scheme. This scheme aims to stimulate the local housing market. The council would be required to make a long term investment with Lloyds Banking Group. For each pound the council invests Lloyds will add four pounds to form a pot of funding which Lloyds Banking Group will use to provide up to 95% mortgages to first time buyers in this area if certain criteria are met. The risk of default is shared between the mortgagee, the council and Lloyds so there is a risk to the capital sum invested. The term of the investment would initially be for five years, although this may increase to seven years if the mortgagees have been in arrears during the initial five year period.

4.3 **UK Building Societies.** The building society sector has been weakened by the banking crisis. There have been a number of high profile takeovers and some requiring government intervention. The difficulties experienced here reflect an over exposure to short-term borrowing from the money markets; or to commercial and other lending which has turned bad in the recession. Therefore in current conditions it is appropriate only to invest in building societies with high credit ratings as for banks. Subject to proposals on credit ratings later in this paper four qualify at this point: Nationwide, Yorkshire, Coventry and Leeds.

4.4 **Money Market Funds** Currently MMFs are offering a slightly higher return than typical bank deposits, but fee structures are different. As mutual funds that invest in a portfolio of short term, high quality debt instruments they are considered to be an effective tool to diversify credit risk and interest rate risk, while retaining instant access in the same way as for call accounts.

Investing in a Money Market Fund is different to normal bank deposits. The mix of assets typically includes commercial paper, certificates of deposit as well as time deposits. In other words there is exposure to financial and commercial institutions with which the council would not normally make direct deposits, including non-UK businesses. The risk is diluted by the Fund spreading its investments. However there is no guarantee from the parent company should the MMF get into difficulties. Whilst there is some additional risk investing in money market funds, the most highly rated funds are widely used by Local Authorities and it is proposed that we reintroduce selected Market Funds into our counterparty list to provide a wider range of investment options.

4.5 **Counterparty limits**. The Council reviewed its limits in 2009/10 following advice on the Strategy commissioned from the brokers Sterling International. These were reduced to a maximum of £5m with the largest banks. An exception is made for the council's own bankers (currently Barclays Bank) where a limit of £10m is more appropriate. This is because at certain times of the month a balance £5m - £10m is required to meet payments due to creditors and employees on the same day.

However, investments are effectively only made on call. It is proposed these limits are retained and applied as follows:

- A ***maximum limit of £5m*** should apply to the highest rated (short –term F2, P2 and A2, combined with long – term A-, A3 and A, ('Strong' or higher grade in Appendix B) ***banks and building societies*****. A lower limit of £3m** should apply to institutions with lower ratings (short –term F3, P3, A-3) ('Adequate Grade' in Appendix B).

- Banks within the same ownership group are treated as a single counterparty for the purpose of setting limits. ***The maximum investment for the group is therefore £5m.***

- It can be difficult to place relatively small deposits with the largest most highly rated banks so the counterparty list is applied as appropriate to the Council's needs.

- It is proposed for 2013/2014 that for ***District Council's*** the counterparty limit shall remain at ***£3m*** and for all ***other UK local authorities*** the limit shall be remain at ***£5m*** to reflect their scale and credit-worthiness.

- A maximum investment of £3m be made in Money Market Funds with the highest credit rating

4.6 In light of the current conditions investing for up to **three *months*** should be the upper limit for investments with financial institutions and in total that investment be limited to £5m. The remainder of the portfolio will be limited to a term of one month with on-call investments being common. This allows for the uncertainties which still surround the liquidity and solvency of banks mentioned in section 2; and the fact that because of the policy of deferred borrowing available balances will continue to fall. It also allows for conditions to change which triggers a decision to recommence borrowing. The upper limit for the DMO and other local authorities can be higher, up to 6 months, because as tax raising authorities they offer greater security. It is not anticipated that interest rates will rise in 2013/14 and the slight lengthening of terms on a proportion of the investment portfolio proposed in this report should increase yields without compromising overall liquidity.

Credit Risk Assessment

4.7 **Credit ratings**. Our approach to credit ratings is that these are a starting point for determining suitable counterparties. At this stage no change is proposed from last year. There is a risk that the UK's AAA sovereign credit rating could be lost at some point in the next two years. If this happens it is likely that UK financial institutions will also be downgraded and this may mean some of our current counterparties slip below the minimum investment rating of adequate. At this point a review of the current policy will be required to ensure we have sufficient counterparties.

In line with the bands set out in the Audit Commission paper 'Risk and Return' attached here as **Appendix B,** and in common with practice in other local authorities

investments, are now made with institutions with an adequate **grade** or above, based on the ratings of the three main credit rating agencies.

4.8 As now, where an entity has its credit ratings downgraded so that it no longer meets the Council's criteria, no new investments should be made, and any that can be recalled without loss of interest should be. Where a rating agency announces that the entity is on "rating watch negative" or "on review for possible downgrade" a similar policy is applied, if the resulting ratings are likely to be below the minimum criteria. When these warnings are withdrawn new investments can be made after an evaluation of the reasons for the changed opinion.

4.9 To supplement credit ratings the council uses generally available market information, quality press, information on government support for banks and sovereign debt ratings, share prices of banks, audited accounts of banks, shared knowledge from brokers, other local authorities. The council is also a member of the CIPFA Treasury Management Network which promotes best practice in public sector treasury management through training, sharing peer expertise, and on-line information.

4.10 The criteria for specified investments should therefore be:

- Short-term deposits with UK banks and building societies, which are rated by at least two of the rating agencies and hold as a minimum an "F3" rating from Fitch, a "P-3" rating from Moody's and an "A-3" rating from Standard and Poor's combined with an adequate long-term rating as set out in paragraph 4.5.

- Government institutions: In effect this means the Debt Management Office (DMO) and all UK local authorities (as defined by the section 23 of the Local Government Act 2003). Where government bodies offer the same terms as commercial borrowers, the Council should seek to invest first with the government body, due to the reduced risk of default.

- Money Market Funds with the highest credit rating with at least one credit rating agency. That is either rated as AAAMmf with Fitch or rated AAAm with Standards and Poor or rated Aaa-mf with Moody's.

4.11 A list of counterparties which currently meet these criteria is at **Appendix C**. It is proposed that for the next financial year that direct investments are only made in UK financial institutions. As such all Foreign banks have been removed from the counterparty list.
The volatility of credit ratings means that the counterparty list can only be correct at a point in time and urgent decisions on changes may be required. To enable the Treasury Management Service to operate effectively it is proposed that the authority to make changes to the counterparty list is delegated to the Director of Policy and Resources who will report back to members if this authority is used. Such changes would involve banks dropping below "Adequate grade" being removed from the list and any rising from speculative to adequate being added.

4.12 The Council does not have paid external advisors offering advice on the composition of counterparty lists, credit ratings or any other investment advice.

4.13 The Council is increasingly aware of the growing complexity of treasury management. All staff involved with treasury management are provided with training to ensure they have the skills and knowledge to meet the demands of the job including an awareness of available sources of funds and investment opportunities appropriate to an authority of this size, an ability to assess and control risk, knowledge of money and capital markets and an appreciation of the implications of legal and regulatory requirements.

4.14 Overall the **investment strategy for 2013/14** aims to reduce risk by

- Investing for shorter periods (up to three month maximum for banks/building societies with a maximum of £5m invested over one month, up to 6 months for DMO/Local Authorities) and up to seven years with the Local Lend a Hand Scheme.
- Investing in institutions with adequate credit ratings or with greater or equivalent security (DMO, local authorities)
- Applying a maximum limit of £5m (except the council's bank and DMO)
- Applying the limit on the banking group not the individual institution
- Not using any foreign banks for at least the next financial year
- At the same time keeping an appropriate maturity profile of investments to minimize exposure to liquidity risk and interest rate risk.

BORROWING STRATEGY

4.15 The council's current level of debt is £109.8m, after repayment of maturing debt of £5m in 2011/12 and £0.4m to date in 2012/13. **The borrowing requirement** for the proposed capital programme is £12.3m in 2012/13, £15.5m in 2013/14, £13.0m in 2014/15, £1.9m in 2015/16 and £2.7m in 2016/17. There are no expected short-term borrowing requirements, except at financial year end, as the council generally runs a surplus and its investment policy aims to ensure cash is available to meet liabilities to creditors at each stage of the cycle. However the facility to make short-term borrowings should be retained to cover unforeseen events.

4.16 **Criteria for borrowing decisions**. In recent years council borrowing has focussed on 25 year fixed interest loans provided through the PWLB as providing best value in the long-run. The Public Works Loan Board (PWLB) is a statutory body operating within the UK Debt Management Office, an executive agency of H M Treasury. Its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

4.17 There are however continuing concerns about the stability of financial markets and therefore the security of council deposits with financial institutions. For the past four years the council has adopted a policy of using internal borrowing (current cash balances) to fund its capital programme, ***deferring any decision to borrow*** until the markets are more settled. This has the benefit of reducing the amount of cash exposed in financial markets. It also has the medium-term benefit of reducing the cost of debt financing for the Council at a time when it has to make substantial reductions in revenue spending. Bank base rates (0.5% to 2% projected for 2013/16) mean the

return on cash balances are well below likely long-term borrowing rates over the plan period.

4.18 There is a trade off here between medium and long term financial benefits of delayed borrowing. A key issue is the scale of capital investment the council chooses to make in its schools; roads and regeneration; care, leisure, housing and other council facilities. On past experience the need has been greater than the resource the council could secure through grant and private sector contributions or generate through the sale of surplus assets. If the council wishes to invest more in its assets then there will be a need to borrow. How much it is prudent to borrow depends on the headroom it can create by reducing the direct costs of running services or increasing its income, and the price it has to pay for that borrowing.

4.19 On the current capital programme the policy of using cash balances can be continued in 2013/14. However when cash balances fall permanently below zero the policy will not be sustainable. There is therefore an argument that borrowing soon at historically low rates may be the most advantageous approach in the long-run, since there is no certainty that these rates will persist.

It is proposed that, subject to decisions made on capital investment, and while circumstances remain favourable this strategy continues. But the Director of Policy and Resources should keep the policy under review. In addition trigger points to review the policy are proposed when the PWLB 25 year annuity rate falls below 3.15% then 2.6%, or exceeds 4.15% and then 5.15%, and when the differential between the 25 year rate and the Bank of England Base Rate narrows to less than 2.5%.

4.20 **Operational leases** were for many years the preferred funding method for vehicles, plant and some small items of equipment on value for money grounds. The relative value for money of leasing to borrowing changes over time and for specialist vehicles such as refuse lorries borrowing has been the cheaper route. More recently the policy has been to use capital receipts to cover the cost of new vehicle purchases. As a result it has been possible to reduce the revenue budget provision for the lease costs of fleet vehicles an annual saving of £880k to date.

4.21 **Counterparties**. As indicated earlier the preferred lender is the PWLB but other lenders may be considered depending on circumstances.

4.22 **Use of LOBOs and structured debt.** No use of these financial instruments is proposed.

4.23 **Limits on fixed and variable debt.** Use of variable debt is one way of reducing exposure to interest rate risk as rates tend to move in line with money market rates. There is no proposal to change the limits for variable debt, but the option should be considered as part of the wider borrowing and investment strategy.

4.24 **Limits on maturity.** An ideal borrowing strategy aims for an even profile of maturing debt, to minimize exposure to refinancing risk. This can also limit the scale of the debt burden. At the same time the borrowing term needs to match the likely life of the asset being financed. It is therefore proposed that all options are considered: the term of the

loan, whether fixed or variable, and the basis of repayment, at term, using an annuity or by equal annual instalments. New borrowing should aim for an average below 5% annual cost of capital. The money market can occasionally provide funds that undercut PWLB levels and this option should be considered in that context.

4.25 **Debt rescheduling.** Council officers continue to monitor the possibility of debt rescheduling. The reasons for any rescheduling to take place include the generation of cash savings at minimum risk and to enhance the balance of the long-term portfolio. Early repayment of debt is also an effective way of reducing cash balances as long as there are no penalties. Opportunities are constrained by the requirement to pay premiums for the early repayment of debt. The position will be kept under review.

4.26 **Minimum revenue provision.** The Council is required to make revenue provision to repay capital spend that is financed by borrowing (either supported or unsupported). This is called the Minimum Revenue Provision (MRP). Where capital expenditure is not resourced immediately (as in the current policy of deferred borrowing), this will result in a net increase to the capital financing requirement and represents an increase in the underlying need to borrow for a capital purpose. An MRP provision is required whether or not external borrowing actually occurs.

The government has issued regulations that require full Council to approve an MRP Policy in advance each year. The Council is recommended to approve the following statement which ensures that the estimates make a prudent provision in line with requirements:

North Lincolnshire Council will make prudent minimum revenue provision for all supported and unsupported borrowing. For all supported borrowing the council will use the CFR method. This calculation is based on the concept of the Capital Financing Requirement (CFR), which is easily derived from the balance sheet: MRP is equal to 4% of the CFR at the end of the preceding financial year. For all new borrowing under the Prudential system for which no government support is being given and is therefore self- financed Council will make provision either in equal instalments over the estimated life of the asset for which the borrowing is undertaken or the annuity method where the set aside increases over the life of the asset.

4.27 **Prudential indicators.** The Prudential Code sets out prudential indicators that must be used, and factors that must be taken into account to show that the council is fulfilling the aims of the code. The indicators are not intended to be comparative with other local authorities and the Code does not include suggested limits or ratios. They are designed to support and record local decision-making in a manner that is publicly accountable.

The proposed indicators are set out at **Appendix D.** They set limits on the maximum level of borrowing which may be made in the financial year, but can be revised by council if necessary at a later date. The limits have been set so as to allow borrowing to meet the needs of the capital programme (should the presumption of deferred borrowing change), plus an allowance for contingencies should adverse factors affect normal cashflow. They also set parameters for the maturity structure of debt and the mix of fixed and variable debt.

4.28 The Prudential Code requires the Director of Policy and Resources to monitor all prudential indicators. Regular monitoring is undertaken in-year against all prudential indicators. Significant variation in the estimates used to calculate these prudential indicators would trigger a report to the Director of Policy and Resources, which would lead to further investigation and action as appropriate.

4.29 Internal monitoring underpins reporting to Council, Cabinet and the Audit Committee. This is done at the special meeting of Council to set the council tax (strategy approval); on the closure of accounts in June; and mid-year. Cabinet receives treasury monitoring information as part of the budget review reports during the year. These are generally in June (outturn), September/October and January. The Audit Committee receives reports at the quarterly meetings.

4.30 The proposed **borrowing strategy for 2013/2014** is therefore

- To delay borrowing for a further year and use cash balances should cashflow and spending needs permit.
- To aim to borrow only to support the cost of the capital programme, net of the Minimum Revenue Provision
- Retaining the option to borrow for cash flow purposes should this be necessary
- To borrow for capital investment purposes at a time which is most advantageous on cost. The Council will not normally borrow more than or in advance of its needs. Any decision to borrow in advance will be considered carefully to ensure value for money and that the Council can ensure security of such funds
- To maximize borrowing through the PWLB at the most appropriate maturity mix (whether fixed, variable, annuity or EIP), while this remains the best value for money option
- To consider debt rescheduling if circumstances are appropriate.

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)

5.1 Financial

The financial implications of this report are reflected in the 2013/17 financial plan and capital programme.

6. OTHER IMPLICATIONS (STATUTORY, ENVIRONMENTAL, DIVERSITY, SECTION 17 - CRIME AND DISORDER, RISK AND OTHER)

6.1 Statutory

Statutory and best practice requirements are taken into account when framing the Treasury Management Strategy (see paragraphs 2.1 to 2.6)

6.2 Risk

The approach to managing risk is a key element of the treasury strategy and is addressed in the body of the report.

7. OUTCOMES OF CONSULTATION

7.1 Not required

8. RECOMMENDATIONS

8.1 That council approve

a) The Treasury Management Investment and Borrowing Strategy for 2013/14

b) The prudential indicators for 2013/16 at Appendix D

c) The policy on the Minimum Revenue Provision.

d) That council approves the current list of approved financial institutions at **Appendix C** and delegates to the Director of Policy and Resources the authority to make changes to the list as necessary, within the guidelines approved above. Any changes to be reported back to Council, Cabinet and Audit Committee as part of the regular reporting process.

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Background Papers used in the preparation of this report

CIPFA Code of Practice in the Public Service Fully Revised 2011
CIPFA The Prudential Code Fully Revised Second Edition 2011
DCLG Guidance
Local Government Act 2003

APPENDIX A

HM Treasury survey of forecasts

Bank Rate Forecasts	Bank Rate (%) Q4 2012	Average Bank Rate (%)*			
		2013	2014	2015	2016
Average	0.5	0.53	0.74	1.44	2.04
Highest	0.5	0.6	1.6	4.02	3.60
Lowest	0.5	0.25	0.25	0.5	0.50

*HM Treasury Forecasts for the UK Economy–November 2012

Office of Budget Responsibility

	Forecast Per cent			
OBR (Nov 2012)	**2012**	**2013**	**2014**	**2015**
GDP Growth	-0.1	1.3	2.0	2.3
CPI Inflation	2.7	2.1	2.0	2.0

'RISK AND RETURN', AUDIT COMMISSION March 2009 APPENDIX B

Audit Commission grading (for the purpose of standardisation)[1]	Fitch		Moody's		Standard and Poor's	
	Long term	Short term	Long term	Short term	Long term	Short term
Extremely strong grade	AAA	F1+	Aaa	P-1	AAA	A-1+
Very strong grade	AA+	F1+	Aa1	P-1	AA+	A-1+
	AA	F1+	Aa2	P-1	AA	A-1+
	AA-	F1+	Aa3	P-1	AA-	A-1+
Strong, but susceptible to adverse conditions grade (strong grade)	A+	F1+ F1	A1	P-1	A+	A-1+ A-1
	A	F1	A2	P-1 P-2	A	A-1+
	A-	F1 F2	A3	P-1 P-2	A	A-1+ A-2
Adequate grade	BBB+	F2	Baa1	P-2	BBB+	A-2
	BBB	F2 F3	Baa2	P-2 P-3	BBB	A-2 A-3
	BBB-	F3	Baa3	P-3	BBB-	A-3
Speculative grade	BB+	B	Ba1	Not prime (NP)	BB+	B-1
	BB	B	Ba2	NP	BB	B-2
	BB-	B	Ba3	NP	BB-	B-3
Very speculative grade	B+	B	B1	NP	B+	-
	B	B	B2	NP	B	-
	B-	B	B3	NP	B-	-
Vulnerable grade	CCC	C	Caa1	NP	CCC+	C
	CCC	C	Caa2	NP	CCC	C
	CCC	C	Caa3	NP	CCC-	C
	CC	C	-	NP	CC	C
	C	C	Ca	NP	C	C
Defaulting grade	D	D	C	NP	D	D

Source: Audit Commission adaptation of information from Fitch, Moody's and Standard and Poor's

APPENDIX C

BANKS	**Fitch Ratings**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	ST	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
United Kingdom							
Barclays Bank	F1	A	P1	A2	A-1	A+	£10,000,000
Co-operative Bank	F2	BBB+	P2	A3			£3,000,000
HSBC Bank plc	F1+	AA-	P1	Aa3	A-1+	AA-	£5,000,000
Lloyds Banking Group							£5,000,000
Bank of Scotland	F1	A	P1	A2	A-1	A	
Lloyds TSB Bank	F1	A	P1	A2	A-1	A	
RBS Group							£5,000,000
National Westminster Bank	F1	A	P2	A3	A-1	A	
Royal Bank of Scotland	F1	A	P2	A3	A-1	A	
Northern Rock Asset Management Plc			P1	Aa3	A-1	A	£5,000,000
Virgin Money	F3	BBB			A2	BBB+	£3,000,000
Standard Chartered Bank	F1+	AA-	P1	A1	A-1+	AA-	£5,000,000

BUILDING SOCIETIES	**Society Asset's**	**Fitch**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	£m	**ST**	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
Nationwide	188,878	F1	A+	P1	A2	A-1	A+	£5,000,000
Yorkshire	30,086	F2	BBB+	P2	Baa2	A-2	A-	£3,000,000
Coventry	22,302	F1	A	P2	A3			£5,000,000
Leeds	9,503	F2	A-	P2	A3			£5,000,000
GOVERNMENT INSTITUTIONS								
Debt Management Office								Unlimited
Local authorities								
District Council's								£3,000,000
All Other LA's								£5,000,000
Fire Authorities								£5,000,000
Police authorities								£5,000,000

MONEY MARKET FUND	**Fitch**	**Moody's**	**Standard & Poor's**
Funds rated by at least one agency as:	AAAMmf	Aaa-mf	AAAm

NOTE: Credit Ratings correct at 28 January 2013.

Appendix D

Prudential Indicators for 2013/14 to 2014/15

Adoption of the CIPFA Code of Practice

The first prudential indicator is that the Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Service. It was adopted by the Council in October 2002, and as subsequently revised in 2011.

Authorised Limit

The Council is asked to approve authorised limits for its total external debt gross of investments for the next three financial years.

Authorised limit for external debt	**2013/2014**	**2014/2015**	**2015/2016**
	£'000	**£'000**	**£'000**
Borrowing	268,000	276,000	282,000
Other Long Term Liabilities	5,000	5,000	5,000
TOTAL	273,000	281,000	287,000

These authorised limits are consistent with the Council's current commitments and Capital strategy. They represent the worst case scenario.

Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

Operational Boundary

The proposed operational boundary for external debt is based on similar estimates to the authorised limit. It reflects the maximum external debt projected by the estimates but reflects a prudent and not worst case position. In practice given our policy of deferring borrowing this limit is unlikely to be breached unless market conditions change sufficiently to trigger a policy review.

Operational boundary	**2013/2014**	**2014/2015**	**2015/2016**
	£'000	**£'000**	**£'000**
Borrowing	215,000	222,000	226,000
Other Long Term Liabilities	2,000	2,000	2,000
TOTAL	217,000	224,000	228,000

Actual External Debt

The prudential indicator for actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt will reflect the actual position at one point in time. This prudential indicator will be the closing balance for actual gross borrowing plus other long term liabilities taken directly from the balance sheet. Actual external debt at 31 March 2012 was £111m (£116m 31 March 2011).

Interest Rate Exposure

The Council must set an upper limit on its fixed interest rate exposures and an upper limit on its variable rate exposures. No change is proposed to current limits.

	2013/2014	**2014/2015**	**2015/2016**
	%	**%**	**%**
Upper limit for fixed rate exposure	100	100	100
Upper limit for variable rate exposure	20	20	20

Maturity Structure of Borrowing

The Council must set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowing. No changes are proposed to current limits.

Maturity structure of borrowing	**Upper Limit**	**Lower Limit**
Under 12 months	15%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	25%

Total principal sums invested for periods longer than 364 days.

The Council does not plan to invest, for periods longer than 364 days, except potentially for the Local Lend a Hand Scheme.