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| <b>Agenda Item</b> |
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| <b>Cabinet</b> |
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| <b>1<sup>st</sup> February 2012</b> |
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| <b>TMS/CR</b> |
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| <b>2012/13 Treasury Management Strategy</b> |
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**Summary**

The Chartered Institute of Public Finance and Accountancy (CIPFA) produce a Code of Practice for Treasury Management in the Public Services. One of the main recommendations of this code is the requirement to have an annual Treasury Management Strategy formally adopted by the Cabinet. There is also a requirement to set prudential indicators relating to all treasury activities that the authority will undertake in the forthcoming financial year. These indicators are appended to the 2012/13 budget report included on the agenda.

**Recommendation**

**The Council adopts this Treasury Management Strategy for 2012/13.**

**The Council adopt the amended Authorised Limit & Operational Boundaries for Debt for 2011/12, to allow Prudential Borrowing for the HRA Self Financing.**

**a) Reasons for Recommendation**

The Council is required to formally adopt a Treasury Management Strategy before the beginning of the financial year.

To allow the Council to undertake borrowing, for the express purpose of funding the £84.782 Million of HRA debt, under the self financing regime.

**b) Alternative Options**

To not adopt the strategy or approve borrowing for HRA self financing.

**c) Risk Considerations**

The Council would fail to comply with CIPFA recommended 'best practice' for treasury management.

The Council would be in not be able to pay over to the government the £84.782 million on 28<sup>th</sup> March and would incur penalty charges and interest

**d) Policy and Budgetary Considerations**

Recommending a Treasury Management Strategy provides a clear working framework for officers to adhere to in all aspects of their treasury management duties



## e) Date for Review of Decision

February 2013

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### 1. Introduction

- 1.1 The CIPFA Code of Practice for Treasury Management in the Public Services and guidance from Communities and Local Government (CLG) on Local Government Investments in England require that the Council adopt an Annual Treasury Management Strategy.
- 1.2 The code and guidance requires that the Authority's Cabinet to be informed of; position on debt and investments, the use of credit ratings in selecting counterparties, the use of treasury advisors, the overall borrowing limits, the prospect on interest rates and whether there are likely to be any material transactions that will be required to or from reserves or investment portfolios.

### 2. Investment Policy & Strategy

- 2.1 The overriding policy objective is to manage the Councils funds prudently, ensuring that we minimise risks while maximising returns, to this aim the Councils investment priorities, are:

- Security of the invested capital;
- Liquidity of the invested capital;
- Yield, which is in line with security and liquidity.

- 2.2 Investments are categorised as 'Specified' or 'Non Specified'.

Specified investments are required to be in Sterling and have a maximum maturity of 1 year; and are either:

- Investments in UK Government
- Investments in Local Authorities
- With institutions or schemes of a 'high credit quality' as determined by the Council.

'High credit quality' is determined as:

Investments in institutions with a credit rating of at least A/F1, including investments in the European Development Banks, to provide more security the capital invested per institution is limited depending on their credit ratings as follows:

AA-/F1+ 20% of value of external fund

A/F1 10% of the value of external fund

Internal Investments less than 6 months, up to agreed limits, in Top 20 UK Building Society's with an asset basis of over £1 Billion and up to £2 Million in Money Market Funds.

Non Specified investments are:

- Investments greater than 1 year up to a maximum of 50% of the value of the external fund (which currently stands at £30.4 Million)
- Corporate Bonds up to a maximum of 20% of the external investment fund (if CLG guidance is amended in line with current consultation on the Capital Financing System)

Please see appendices A & B for a full list of counterparties and limits.

2.3 While the conditions set out in 2.2 provide the basis for setting our counterparty list, we currently have restricted our investments within the Eurozone countries to Deutsche Bank, Rabobank International, Nordea Bank, European Investment Bank And European Bank for Reconstruction, as agreed by Cabinet on 2<sup>nd</sup> November 2011.

2.4 The Council selects it's counterparties with reference to;

- Credit ratings as provided by the three main rating agencies – Fitch, Moody's and Standard & Poor's
- The financial returns of Building Societies (internal only)
- News, articles and market sentiment

In addition, our external fund managers take into consideration the following when setting limits on duration and capital investment;

- Credit Default Swaps – are used as a market indicator of risk of the counterparty defaulting.
- Support – this is the perceived support an institution will get from the government in the institutions county of origin.

All credit ratings are reviewed at least monthly and more frequently when deemed appropriate, for example in response to statements/articles in the financial press.

2.5 The Council currently employ's treasury consultants to manage its external investment fund of £30.5 million.

Our external fund managers, Investec, have managed the fund for a number of years and the returns they achieve are 'bench marked' against the 7 day LIBID (London Interbank Bid) rate.

However as agreed by Council we will be considering the best option for the future management of this fund, which may include bring this in house and using advisors to assist the team. The finance team need to complete preparation of 2012/13 budgets before undertaking this work.

2.6 In relation to future returns, the UK Bank Base rate is expected to continue at the record low of 0.50% until mid 2013, while the focus is on securing growth over reducing inflation. The Eurozone crisis is still rumbling on and the flight to safe havens continuing, with UK Gilts among these havens for the time being.

As a result market rates will remain low and with this our returns at between 0.5-1%.

This last year has seen many financial institutions having their credit ratings downgraded due to the reduction in the likelihood of further government support and the Eurozone crisis. Resulting in a reduction of the number of counterparties we can deal with.

However, if the proposed changes to local authority capital financing rules come into effect, this opens the way for investments in corporate bonds enabling us to increase diversification in our external investments.

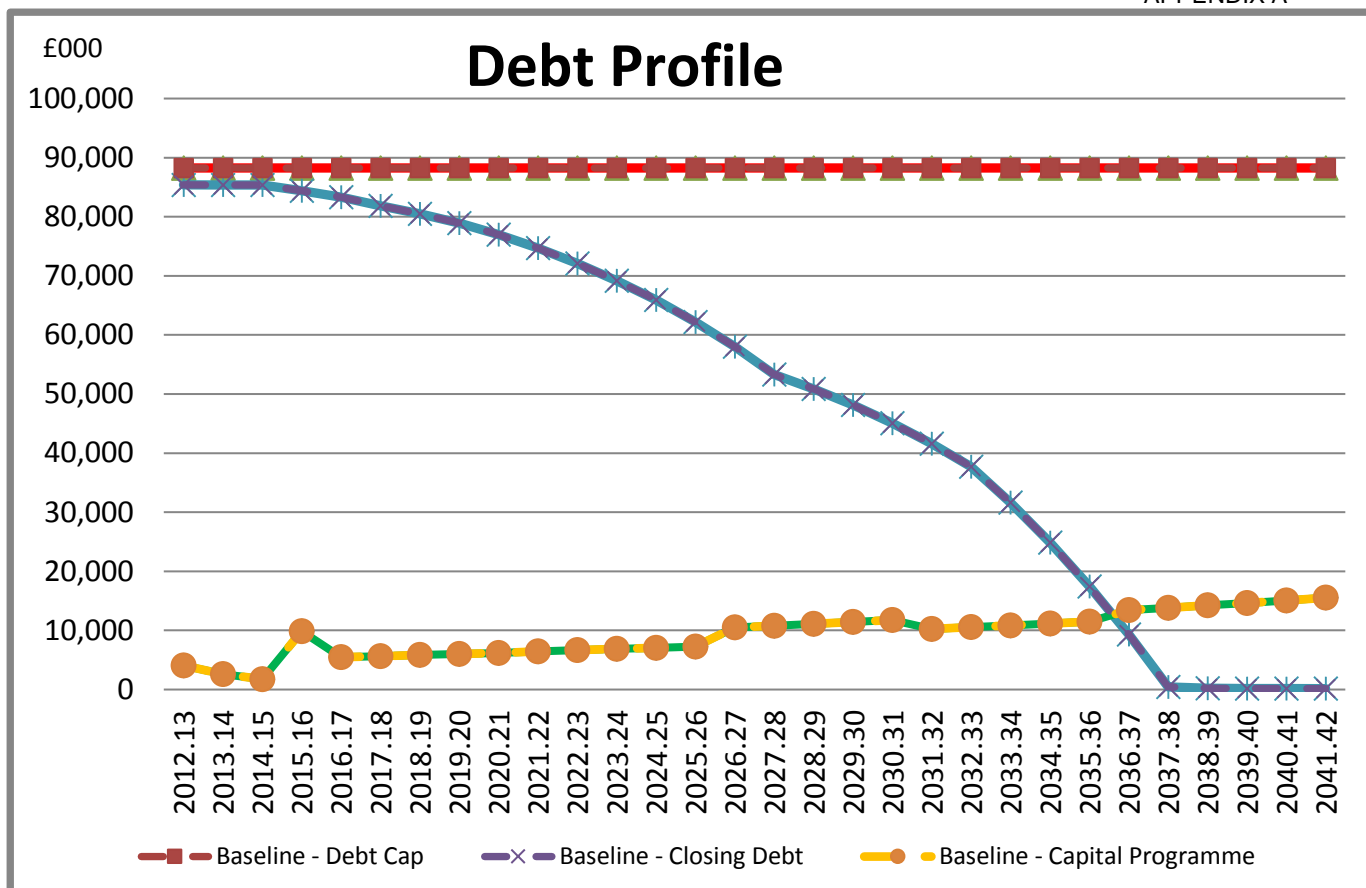
### **3. Borrowing Requirement**

- 3.1 The Council currently has long term borrowings of £1.245 million to cover capital schemes for Recycling & Refuse and Affordable Housing.
- 3.2 Under the governments self financing regime, the Council will be taking on £84.782 million of debt, which will have to be borrowed with repayments being met by the Housing Revenue Account (HRA). Differing options for borrowing have been considered and external advice obtained from Sector Treasury Services.

It is considered that the most prudent option is to borrow the money through the Public Works Loan Board (PWLB), in light of the announcement by HM Treasury to reduce the rates available through the PWLB on 26<sup>th</sup> March 2012 for Councils wishing to borrow for the purpose of HRA self financing. This is widely expected to be a reduction of 0.85% on rates currently on offer.

PWLB loan rates are set based on the rate at which the government can borrow; the yield on Gilts, as a result rates are volatile and likely to change between now and March. Therefore the budget has been set using interest rates available on 2 December (average 3.84%, ranging from 1.65%-4.25), with no reduction applied.

With the decision of who to borrow from set at the PWLB, the next step has been to profile the maturity of the debt to when the HRA Business Plan generates the resources to be able to make repayments (to be made on maturity of the loans).



In setting the profile of repayments, as illustrated above, a balance has been struck between the ability to make repayments as quickly as possible; saving interest payments, whilst ensuring the HRA has enough funds to allow for uncertainties and the ability to invest in stock with its own resources.

The debt repayment profile shows that all associated loans will be repaid by 2039, with debt falling significantly up to this point.

Under the Localism Act 2011, Government has the power to put a limit on Local Authorities indebtedness, with regards to the HRA. This has been set at £88.249 for the HRA and this is used in the prudential indicators as our Authorised Limit for HRA debt.

- 3.3 To enable the borrowing of £84.782m on 26<sup>th</sup> March for the HRA Self Financing regime, the Council is asked to approve the revised 2011/12 prudential operational boundary of £85.412 Million and the authorised limit for external debt of £88.249 Million.
- 3.4 Currently there is no plans/requirement for the General Fund to borrow to support its capital programme in 2012/13.
- 3.5 As part of the CIPFA code for Treasury Management it is recommended that the Cabinet is informed of the anticipated borrowing limits required for the forthcoming financial year. These limits are included in the prudential indicators appended to the 2012/13 budget report on the agenda.

In addition to loans mentioned earlier, the Council will still need to make use of short term borrowing to meet day to day cash flow shortfalls. The limits on the level of borrowings are stated below:

**Operational boundary for external debt** – estimate of the prudent (most likely) level of external debt, taken from the authorities' estimate of its capital financing and cash flow requirements.

| <b>Table 8 Operational Boundary for External debt (Estimated)</b> |              |                               |               |               |               |
|---|--------------|-------------------------------|---------------|---------------|---------------|
|   | Actual       | Per 11/12 Est. as at 22/12/10 |               |               |               |
|   | 2010/11      | 2011/12                       | 2012/13       | 2013/14       | 2014/15       |
|   | £000's       | £000's                        | £000's        | £000's        | £000's        |
| Borrowing - General Fund  | 3,799        | 4,539                         | 5,479         | 6,193         | 6,962         |
| Other LTL's - General Fund  | 733          | 670                           | 667           | 632           | 467           |
| <b>General Fund Total</b>   | <b>4,532</b> | <b>5,209</b>                  | <b>6,146</b>  | <b>6,825</b>  | <b>7,429</b>  |
| Borrowing - HRA   | 646          | 85,412                        | 85,396        | 85,379        | 84,391        |
| Other LTL's - HRA   | 0            | 0                             | 0             | 0             | 0             |
| <b>HRA Total</b>  | <b>646</b>   | <b>85,412</b>                 | <b>85,396</b> | <b>85,379</b> | <b>84,391</b> |
| <b>Overall Total</b>  | <b>5,178</b> | <b>90,620</b>                 | <b>91,541</b> | <b>92,205</b> | <b>91,819</b> |

**Authorised limit for external debt** – the operational boundary plus headroom to provide for any unusual cash flows.

| <b>Table 7 Authorised Limit for External debt (Estimated)</b> |              |                               |               |               |               |
|---|--------------|-------------------------------|---------------|---------------|---------------|
|   | Actual       | Per 11/12 Est. as at 22/12/10 |               |               |               |
|   | 2010/11      | 2011/12                       | 2012/13       | 2013/14       | 2014/15       |
|   | £000's       | £000's                        | £000's        | £000's        | £000's        |
| Borrowing - General Fund                                      | 3,799        | 7,539                         | 8,479         | 9,193         | 9,962         |
| Other LTL's - General Fund                                    | 733          | 670                           | 667           | 632           | 467           |
| <b>General Fund Total</b>                                     | <b>4,532</b> | <b>8,209</b>                  | <b>9,146</b>  | <b>9,825</b>  | <b>10,429</b> |
| Borrowing - HRA   | 646          | 88,249                        | 88,249        | 88,249        | 88,249        |
| Other LTL's - HRA   | 0            | 0                             | 0             | 0             | 0             |
| <b>HRA Total</b>  | <b>646</b>   | <b>88,249</b>                 | <b>88,249</b> | <b>88,249</b> | <b>88,249</b> |
| <b>Overall Total</b>  | <b>5,178</b> | <b>96,458</b>                 | <b>97,395</b> | <b>98,074</b> | <b>98,678</b> |

**Actual External Debt** as at 31<sup>st</sup> March 2011 = £4.45 Million (General fund = £3.8m & HRA £0.65m).

#### 4. Treasury Indicators

- 4.1 As per the CIPFA Code, it is recommended that Cabinet is informed of the limits on fixed and variable interest exposure, the maturity structure of borrowing and the upper limit for the total of principle sums invested longer than 364 days.

- 4.2 **Interest rate exposure** – In general we only make use of investment & borrowing instruments which are at fixed rates, with the exception of a call account which is linked to the base rate and therefore may vary over the time the money is invested. Based on the projected investment and borrowing requirements of the Council over the next three years the upper limit on fixed interest rate exposure is;

| <b>Interest Rate Exposure</b> |                             |                 |                    |                 |
|-------------------------------|-----------------------------|-----------------|--------------------|-----------------|
|                               | <b>General Fund (£,000)</b> |                 | <b>HRA (£,000)</b> |                 |
|                               | <b>Fixed</b>                | <b>Variable</b> | <b>Fixed</b>       | <b>Variable</b> |
| 2010/11 (actual)              | 97.38%                      | 2.62%           | 98.80%             | 1.20%           |
| 2011/12                       | 99.06%                      | 0.94%           | 99.99%             | 0.01%           |
| 2012/13                       | 99.09%                      | 50.00%          | 100.00%            | 50.00%          |
| 2013/14                       | 99.19%                      | 50.00%          | 100.00%            | 50.00%          |
| 2014/15                       | 99.30%                      | 50.00%          | 100.00%            | 50.00%          |

- 4.3 **Maturity structure of borrowing** – this is the amount of projected long term borrowing that is due for repayment in each period.

| <b>Maturity Structure of Fixed Rate Borrowing as % of Total Borrowing</b> |                   |  |                |  |                |
|---|-------------------|--|----------------|--|----------------|
|   |                   | <b>General Fund</b>                              |                | <b>HRA</b>                                       |                |
|   |                   | <b>Projected Borrowing Amount Maturing £,000</b> | <b>Total</b>   | <b>Projected Borrowing Amount Maturing £,000</b> | <b>Total</b>   |
| Current Year  | 2011/12           | 60   | <b>10.02%</b>  | 16   | <b>0.02%</b>   |
| Next yr   | 2012/13           | 60   | <b>10.02%</b>  | 16   | <b>0.02%</b>   |
| Yr 3-5  | 2013/14 - 2014/15 | 180  | <b>30.05%</b>  | 1,005  | <b>1.18%</b>   |
| Y6 -10  | 2015/16 - 2019/20 | 299  | <b>49.92%</b>  | 7,382  | <b>8.66%</b>   |
| Y11-20  | 2020/21 - 2029/30 | 0  | <b>0.00%</b>   | 31,894   | <b>37.41%</b>  |
| Y21-30  | 2030/31 - 2039/40 | 0  | <b>0.00%</b>   | 44,937   | <b>52.71%</b>  |
|   |                   | <b>599</b>                                       | <b>100.00%</b> | <b>85,250</b>                                    | <b>100.00%</b> |

In addition to this the Council has an overdraft limit of £350,000 and can borrow for periods less than 2 months at fixed rates through our brokers, in order to meet daily cash flow requirements.

- 4.4 **Upper limit for total principle sums invested over 364 days** – The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. This limit is set at 50% of the portfolio.

| Total Principle sums invested for periods longer than 364 days |                                   |                    |                                   |                    |                                   |                    |
|--|-----------------------------------|--------------------|-----------------------------------|--------------------|-----------------------------------|--------------------|
|  | General Fund                      |                    | HRA                               |                    | Total                             |                    |
|  | Estimate total investments £'000s | Upper limit £'000s | Estimate total investments £'000s | Upper limit £'000s | Estimate total investments £'000s | Upper limit £'000s |
| 2011/12  | (30,161)                          | (15,081)           | (1,236)                           | (618)              | (31,397)                          | (15,699)           |
| 2012/13  | (30,408)                          | (15,204)           | (2,970)                           | (1,485)            | (33,378)                          | (16,689)           |
| 2013/14  | (30,712)                          | (15,356)           | (6,918)                           | (3,459)            | (37,630)                          | (18,815)           |
| 2014/15  | (31,019)                          | (15,510)           | (12,240)                          | (6,120)            | (43,259)                          | (21,630)           |

## 5. Other Items

### 5.1 Current Position on Debt and Investments

|   | @ 31/12/11<br>(£'M) |               |
|---|---------------------|---------------|
| <b>Short Term Internal Investments</b>      |                     |               |
| Bank of Scotland call account               | 2.00                |               |
| Fixed Term Cash Deposits < 1 Month          | 8.70                |               |
| Fixed Term Cash Deposits < 2 Month          | 2.00                |               |
| Fixed Term Cash Deposits < 3 Month          | 1.50                |               |
|   | <b>14.20</b>        | <b>31.82%</b> |
| <b>External Investments (at book value)</b> |                     |               |
| Certificates of deposits < 1 Month          | 11.90               |               |
| Certificates of deposits < 3 Months         | 3.00                |               |
| Certificates of deposits < 6 Months         | 8.40                |               |
| Certificates of deposits < 1 Year           | 6.30                |               |
| Cash / Deposits                             | 0.08                |               |
| Fixed Interest Security                     | 0.75                |               |
|   | <b>30.43</b>        | <b>68.18%</b> |
| <b>Total Investments</b>                    | <b>44.63</b>        |               |
| <b>Borrowing</b>                            |                     |               |
| Short Term Cash Flow Borrowing              | 0.00                |               |
| PWLB Loan (General Fund) < 10 years         | 0.60                |               |
| PWLB Loan (HRA) < 40 years                  | 0.65                |               |
|   | <b>1.24</b>         |               |

\*Certificates of Deposits are instruments issued by banks & building societies, at a fixed rate for a fixed term.



- 5.2 Training; CIPFA's revised code requires the Head of Finance (Section 151 Officer) to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

We have a post with specific responsibility for treasury management and we are committed to ensuring the holder gains any relevant qualifications and has access to the training and support they require.

In addition procedures for the finance team are in place and independent checks and authorisations are carried out. The council also maintains an internal audit function through the South West Audit Partnership (SWAP), who annually carries out a review of our treasury management function.

- 5.3 Use of Reserves; the draft 2012/13 budget has been compiled on the basis that the Council will make the following withdrawals from reserves

|  |                  |
|--|------------------|
|  | £'M              |
| General Fund Balance                             | 0                |
| Capital Reserves                                 | 1,575            |
|  | <u>1,575</u>     |
| Transformation Reserve<br>(Balance £1.6 Million) | To be determined |

The final amount to be withdrawn from reserves is subject to the final decision of full council on 22<sup>nd</sup> February 2012.

We will keep under review the need to withdraw any further funds from our investment portfolio.

## Legal Implications

## Financial Implications

These are as stated in the report

## Background Papers

- ❑ CIPFA Treasury Management codes of Practice and Guidance Notes 2011
- ❑ CLG Guidance on Investments 2011
- ❑ CLG Consultation paper on changes to the capital financing system.
- ❑ CIPFA Prudential Code 2011
- ❑ CIPFA Guide to Housing Self-financing
- ❑ Investec returns and papers
- ❑ Treasury working papers

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