REPORT TO:	**FINANCE AND MANAGEMENT COMMITTEE**	**AGENDA ITEM: 8**
DATE OF MEETING:	**20st FEBRUARY 2014**	**CATEGORY: RECOMMENDED**
REPORT FROM:	**Director of Finance**	**OPEN**
MEMBERS' CONTACT POINT:	**KEVIN STACKHOUSE (01283 595811) Director of Finance & Corporate Services** **Kevin.stackhouse@south-derbys.gov.uk**	**DOC:** u/ks/treasury management/strategies/strategy 2014-15
SUBJECT:	**TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2014/15**	**REF:**
WARD(S) AFFECTED:	**ALL**	**TERMS OF REFERENCE: FM 08**

1.0 Recommendations

1.1 That the Treasury Management Strategy for 2014/15 is considered and approved.

1.2 That the Prudential Indicators and Limits for 2014/15 to 2018/19 as set out in **Appendix 1** are approved.

1.3 That the Investment Strategy for 2014/15 including the associated counterparty (lending) list and policy is considered and approved.

2.0 Purpose of the Report

2.1 To detail the Council's Prudential Indicators for its expected treasury operations for 2014/15 and beyond. This fulfils the requirements of the Local Government Act 2003, updated for the implications arising out of the Localism Act 2011. Three main areas are covered:

- The CIPFA Prudential Code (2011) requires the reporting of the Indicators for Capital Finance in Local Authorities.
- The Treasury Strategy in accordance with the CIPFA Code of Practice on Treasury Management.
- The Investment Strategy in accordance with Government guidance (2010).

3.0 Executive Summary

The Prudential System for Capital Finance

3.1 The main aims of the national prudential system are to ensure that:

- Capital investment plans of local authorities are affordable and sustainable.
- Treasury management decisions are taken in accordance with best professional practice.
- Financial planning and asset management are integrated into the Council's overall corporate planning arrangements.

3.2 Treasury operations are measured within a set of prudential indicators. The main purpose of these indicators is to provide the limits and benchmarks to control the level of capital expenditure, borrowing and investment. The Council is expected to operate well within these limits, in particular when borrowing and investing.

The Treasury Management Strategy

3.3 The Strategy aims to provide transparency for treasury decisions including the use of counterparties, together with assessing how risk is managed on a day to day basis. The Strategy includes implications of the HRA debt taken on under the Self Financing Framework.

Prudential Indicators

3.4 The relevant indicators required under the regulations are summarised in the following sections.

Estimated Capital Expenditure

3.5 This is the approved capital investment programme for the General Fund, together with stock investment proposals included in the HRA Business Plan. The programme is summarised in the following table.

Estimated Capital Expenditure	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
General Fund	3,265	1,278	405	1,020	140	0
HRA	5,926	6,289	6,227	6,227	4,180	4,180
Total	**9,191**	**7,567**	**6,632**	**7,247**	**4,320**	**4,180**

3.6 The capital expenditure programme will be financed directly from government grants, external contributions, council reserves and capital receipts. No borrowing is planned to be undertaken to finance this expenditure.

Capital Financing Requirement (CFR)

3.7 The CFR is a measure of the Council's underlying need to borrow for capital investment and is based on the value of its assets contained in the Balance Sheet. It does not represent the amount of actual debt outstanding.

3.8 This is due to the fact that not all borrowing allowed has in effect taken place against this requirement, but is being financed internally through cash deposits and reserves.

3.9 The General Fund CFR is reduced each year by a statutory revenue charge (known as the Minimum Revenue Provision - MRP) but there is no similar requirement for the Housing Revenue Account,

3.10 However, in future years, money will be set-aside to repay HRA debt in accordance with the maturity structure. The expected CFR is detailed in the following table.

Expected CFRs	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
General Fund	5,757	5,410	5,084	4,771	4,470	4,182
HRA	62,860	62,860	62,860	62,860	62,860	62,860
TOTAL	**68,617**	**68,270**	**67,944**	**67,631**	**67,330**	**67,042**

3.11 The CFR on the General Fund will continue to reduce over the medium-term due to the MRP & VRP. This charge, which is £253,000 in 2013/14 and £330,000 in 2014/15, is included in the Council's base budget.

3.12 Effectively, the MRP &VRP creates a cash amount in the Council's budget in order to write down the underlying borrowing requirement. The large CFR on the HRA is forecast to remain static until 2018/19 when we are budgeting to start setting aside money for the repayments of the debt based on the current debt structure.

Operational Boundaries and Limits

3.13 These are summarised in the following table.

Debt Limits	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Authorised Limit - General Fund	5,757	5,410	5,084	4,771	4,470	4,182
Authorised Limit - HRA	66,853	66,853	66,853	66,853	66,853	66,853
Operational Boundary	63,458	63,450	63,450	63,450	63,450	63,450

3.14 The Authorised Limit is the borrowing cap for the Council. It includes the CFR on the General Fund, plus the debt cap set by the Government on the HRA for self-financing, i.e. £66.853m. The Operational Boundary represents the expected fixed debt outstanding in the year, plus a provision for temporary borrowing of £5m.

Cost of Debt to Finance Capital Expenditure

3.15 The estimated cost of debt, to finance the capital programme contained in the consolidated budget proposals on council tax and housing rents, are summarised in the following table.

Cost of Servicing Debt (per year)	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Band D Council Tax	-£0.78	-£1.12	-£0.85	-£1.13	-£1.39	-£0.95
Per Council Dwelling	£520	£521	£559	£597	£626	£655

3.16 As there is no actual debt on the General Fund, the impact on Council Tax is positive as this represents interest on cash deposits. The surplus is expected to rise incrementally in the medium term in accordance with interest rates.

Available Resources for Investment

3.17 This represents balances and reserves held for specific purposes and to act as a contingency / provision. These are the resources the Council has to invest and to internally finance any short term borrowing requirement. The estimated year end position is shown below.

Estimated Resources Available	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
TOTAL	**12,128**	**11,182**	**9,772**	**8,252**	**6,624**	**5,371**

3.18 The table shows an incremental use of balances and reserves as they are drawn down to finance spending. These levels may increase as additional resources, such as Section 106 receipts, are generated.

3.19 It is estimated that the Council will physically have an amount of £7m invested at the year end. In accordance with the Investment Strategy, this will continue to be held in short-term (less than 364 days) reserve accounts.

4.0 Detail

Prudential Indicators for Capital Expenditure and Borrowing

4.1 The Local Government Act 2003 requires the Council to adopt the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Prudential Code and in doing so to calculate and monitor a set of prudential indicators. The Code and indicators should sit alongside the main financial plan.

4.2 The prudential framework is designed to control the level of borrowing and investment activity at a local level. The indicators themselves either summarise the expected treasury activity or place limits upon the activity that reflect the outcome of the Council’s underlying capital expenditure and borrowing requirements.

4.3 A fundamental part of the Code is the requirement to adopt and utilise a Treasury Management Strategy. The Council's proposed strategy for 2014/15 is detailed in **Appendix 2.** The Prudential Indicators are detailed in **Appendix 1** with comments and analysis in the following sections.

Capital Expenditure and Financing

4.4 The approved capital programme is summarised in the following table.

Estimated Capital Expenditure	**2013/14 £**	**2014/15 £**	**2015/16 £**	**2016/17 £**	**2017/18 £**	**2018/19 £**
General Fund	3,264,834	1,277,595	405,100	1,020,000	140,000	0
HRA	5,925,717	6,289,200	6,227,200	6,227,200	4,179,562	4,179,562
TOTAL	**9,190,551**	**7,566,795**	**6,632,300**	**7,247,200**	**4,319,562**	**4,179,562**
Financed By						
Government Grants	273,717	281,000	281,000	281,000	281,000	281,000
Major Repairs Reserve	5,500,000	5,500,000	5,500,000	5,500,000	3,452,362	3,452,362
External / Partnership	1,299,467	272,000	330,000	600,000	0	0
Revenue Contributions	1,144,367	296,800	286,800	286,800	286,800	286,800
Earmarked Reserves	58,000	772,595	55,100	420,000	140,000	0
Capital Reserves	0	159,400	159,400	159,400	159,400	159,400
Capital Receipts	915,000	285,000	20,000	0	0	0
TOTAL	**9,190,551**	**7,566,795**	**6,632,300**	**7,247,200**	**4,319,562**	**4,179,562**

4.5 The table highlights that the 5-year investment programme is fully funded. There is no requirement to enter into any borrowing, i.e. there is <u>no additional net financing requirement</u>.

4.6 If all financing is not secured, expenditure can be curtailed or other resources and reserves identified. Borrowing is undertaken as a last resort to meet any shortfall and this would be undertaken prudentially within the Council's debt limit. It is not expected that any additional borrowing will be required.

The Council's Borrowing Need or Capital Financing Requirement (CFR)

4.7 The CFR is a measure of the Council's underlying need to borrow for capital investment and is based on the net value of its assets contained in the Balance Sheet. Capital expenditure that has not been immediately paid for will increase the CFR through additional borrowing.

4.8 The Council is required to pay off an element of the accumulated General Fund CFR each year through a revenue charge called the Minimum Revenue Provision (MRP). Annual amounts are included in the MTFP.

4.9 There is no requirement to make a MRP for the HRA. This will continue to be the case under self-financing, although in future years, money will be set-aside to repay HRA debt in accordance with the maturity structure.

4.10 A summary of the CFR estimates is shown in the following table.

The Use of the Council's Resources and the Investment Position

4.11 The Council has available at any one time, reserves and balances which are held to finance future expenditure commitments or to act as a contingency sum as recommended by the Chief Finance Officer.

Expected CFRs	**2013/14 £'000**	**2014/15 £'000**	**2015/16 £'000**	**2016/17 £'000**	**2017/18 £'000**	**2018/19 £'000**
CFR b/fwd	69,175	68,617	68,270	67,944	67,631	67,330
Add Net Financing	0	0	0	0	0	0
Repayment of Debt	-305	-7	0	0	0	0
Less MRP	-253	-230	-216	-203	-191	-179
Less VRP	0	-110	-110	-110	-110	-110
CFR c/fwd	**68,617**	**68,270**	**67,944**	**67,631**	**67,330**	**67,042**
General Fund Proportion	5,757	5,410	5,084	4,771	4,470	4,182
HRA Proportion	62,860	62,860	62,860	62,860	62,860	62,860

4.12 These balances are available for investment on a short-term basis in accordance with the Investment Strategy. The expected level of reserves and balances is shown in the following table.

Usable Reserves	**2013/14 £'000**	**2014/15 £'000**	**2015/16 £'000**	**2016/17 £'000**	**2017/18 £'000**	**2018/19 £'000**
General Fund	4,492	4,155	3,637	3,014	2,161	1,057
Earmarked Reserves	3,526	3,049	2,634	2,320	1,920	1,895
HRA	2,114	1,917	1,910	2,027	2,027	2,027
Capital Receipts Reserve	1,997	2,062	1,592	892	517	392
TOTAL	**12,128**	**11,182**	**9,772**	**8,252**	**6,624**	**5,371**

4.13 The table shows an incremental use of balances and reserves as they are drawn down to finance spending. These levels may increase as additional resources, such as Section 106 receipts, are generated.

4.14 It is expected that the Council will physically have an amount of £7m invested at the year end. During the year, this will be much higher and will depend on the overall cash flow position during the financial period.

Limits to Borrowing Activity

4.15 The Council is required to set limits on overall borrowing (net of investments). This controls borrowing and ensures that it 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 the current and the next two financial years.

4.16 A short term deviation is allowed to allow some flexibility if a limited amount of borrowing was required to meet temporary shortfalls in cash flow. The estimated position is detailed in the following table.

Estimated Borrowing Compared to the CFR	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Gross Borrowing - HRA	58,430	58,430	58,430	58,430	58,430	58,430
Gross Borrowing - General Fund	42	35	28	28	28	28
Gross Borrowing - Total	**58,473**	**58,465**	**58,458**	**58,458**	**58,458**	**58,458**
Total CFR	**68,617**	**68,270**	**67,944**	**67,631**	**67,330**	**67,042**

4.17 The above table shows that as gross borrowing is likely to remain below the CFR, the Council will comply with this Prudential Indicator. The HRA borrowing contains the initial debt take-on of £57.4m, together with other borrowing allocated to the HRA on 1st April 2012 of £1m.

4.18 The debt on the General Fund relates to deposits held on account for Parish Councils and these are subject to repayment at short notice. The figures show the estimated year-end position and do not take into account any short-term cash deposits which could offset the CFR.

4.19 The Council's overall financial plans do not at this stage rely on any new borrowing whether on a prudential or unsupported basis.

The Authorised Limit for External Debt

4.20 This represents a limit beyond which external debt is prohibited. It is the statutory limit determined under section 3(1) of the Local Government Act 2003 and includes the debt cap for HRA self-financing of £66.853m.

The Operational Boundary for External Debt

4.21 This represents the expected external debt during the course of the year, but it is not a limit. It is designed to aid the Chief Finance Officer manage treasury activity on a daily basis and acts as an early warning sign of any potential issues. It includes a provision for temporary borrowing of £5m. The Limit and Boundary are summarised below.

Debt Limits	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Authorised Limit - General Fund	5,757	5,410	5,084	4,771	4,470	4,182
Authorised Limit - HRA	66,853	66,853	66,853	66,853	66,853	66,853
Operational Boundary	63,458	63,450	63,450	63,450	63,450	63,450

Affordability Indicators

4.22 These indicators aim to show the cost of borrowing and capital investment plans on the Council's finances, together with their impact on local taxpayers. Under the Prudential System, borrowing needs to be affordable and sustainable in the longer term.

Ratio of Financing Costs to Net Revenue Stream

4.23 This indicator shows the trend in the net cost of borrowing (allowing for investment income) against the net revenue stream, i.e. Council Tax for the General Fund and Rent Income for the HRA. This is shown in the following table.

Financing Ratios	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
General Fund						
Council Tax Income	£4,411,190	£4,485,881	£4,576,066	£4,667,608	£4,760,525	£4,854,835
Net Interest	-£22,950	-£33,358	-£25,570	-£34,381	-£42,573	-£29,483
Proportion	-0.52%	-0.74%	-0.56%	-0.74%	-0.89%	-0.61%
HRA						
Rent Income	11,682,330	12,285,102	12,719,119	13,096,610	13,522,249	13,961,722
Net Interest	£1,564,005	£1,559,413	£1,671,375	£1,781,686	£1,864,878	£1,948,288
Proportion	13.39%	12.69%	13.14%	13.60%	13.79%	13.95%

4.24 With no debt on the General Fund, the amount is negative. The ratio reflects the level of "gearing" - how much of the Council's turnover is tied up in borrowing costs. Although the proportion for the HRA is greater in cost terms, this is affordable within the Business Plan.

Impact of Capital Investment on the Council Tax and Housing Rents

4.25 This indicator then shows how much per year the costs of borrowing impact upon each household (at Band D council tax rate) in the District and for each council tenant (HRA).

Cost of Servicing Debt	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
Net Interest Received - Gen Fund	-£22,950	-£33,358	-£25,570	-£34,381	-£42,573	-£29,483
Estimated Band D Properties	29,359	29,723	30,023	30,323	30,623	30,923
Cost per Band D Property	**-£0.78**	**-£1.12**	**-£0.85**	**-£1.13**	**-£1.39**	**-£0.95**
Estimated Net Interest - HRA	£1,564,005	£1,559,413	£1,671,375	£1,781,686	£1,864,878	£1,948,288
Estimated Dwellings	3,007	2,994	2,989	2,984	2,979	2,974
Annual Cost per Dwelling	**£520**	**£521**	**£559**	**£597**	**£626**	**£655**

5.0 Financial Implications

5.1 As detailed in the report.

6.0 Corporate Implications

6.1. None directly

7.0 Community Implications

7.1 None directly

8.0 Background Papers

8.1 Treasury Management in Public Services and the Code of Practice (Cipfa Publication – November 2011)

8.2 Local Government Act 2003 (Part 1)

8.3 Localism Act 2011 – Part 7 Chapter 3

Appendix 1

LIST OF PRUDENTIAL INDICATORS 2013/14 TO 2018/19

Estimated Capital Expenditure	2013/14 £	2014/15 £	2015/16 £	2016/17 £	2017/18 £	2018/19 £
General Fund	3,264,834	1,277,595	405,100	1,020,000	140,000	0
HRA	5,925,717	6,289,200	6,227,200	6,227,200	4,179,562	4,179,562
TOTAL	**9,190,551**	**7,566,795**	**6,632,300**	**7,247,200**	**4,319,562**	**4,179,562**
Financed By						
Government Grants	273,717	281,000	281,000	281,000	281,000	281,000
Major Repairs Reserve	5,500,000	5,500,000	5,500,000	5,500,000	3,452,362	3,452,362
External / Partnership	1,299,467	272,000	330,000	600,000	0	0
Revenue Contributions	1,144,367	296,800	286,800	286,800	286,800	286,800
Earmarked Reserves	58,000	772,595	55,100	420,000	140,000	0
Capital Reserves	0	159,400	159,400	159,400	159,400	159,400
Capital Receipts	915,000	285,000	20,000	0	0	0
TOTAL	**9,190,551**	**7,566,795**	**6,632,300**	**7,247,200**	**4,319,562**	**4,179,562**

Expected CFRs	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
General Fund	5,757	5,410	5,084	4,771	4,470	4,182
HRA	62,860	62,860	62,860	62,860	62,860	62,860
TOTAL	**68,617**	**68,270**	**67,944**	**67,631**	**67,330**	**67,042**

Expected CFRs	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
CFR b/fwd	69,175	68,617	68,270	67,944	67,631	67,330
Add Net Financing	0	0	0	0	0	0
Repayment of Debt	-305	-7	0	0	0	0
Less MRP	-253	-230	-216	-203	-191	-179
Less VRP	0	-110	-110	-110	-110	-110
CFR c/fwd	**68,617**	**68,270**	**67,944**	**67,631**	**67,330**	**67,042**
General Fund Proportion	5,757	5,410	5,084	4,771	4,470	4,182
HRA Proportion	62,860	62,860	62,860	62,860	62,860	62,860

Debt Limits	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Authorised Limit - General Fund	5,757	5,410	5,084	4,771	4,470	4,182
Authorised Limit - HRA	66,853	66,853	66,853	66,853	66,853	66,853
Operational Boundary	63,458	63,450	63,450	63,450	63,450	63,450

Cost of Servicing Debt	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Net Interest Received - Gen Fund	-£22,950	-£33,358	-£25,570	-£34,381	-£42,573	-£29,483
Estimated Band D Properties	29,359	29,723	30,023	30,323	30,623	30,923
Cost per Band D Property	**-£0.78**	**-£1.12**	**-£0.85**	**-£1.13**	**-£1.39**	**-£0.95**
Estimated Net Interest - HRA	£1,564,005	£1,559,413	£1,671,375	£1,781,686	£1,864,878	£1,948,288
Estimated Dwellings	3,007	2,994	2,989	2,984	2,979	2,974
Annual Cost per Dwelling	**£520**	**£521**	**£559**	**£597**	**£626**	**£655**

Financing Ratios	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
General Fund						
Council Tax Income	£4,411,190	£4,485,881	£4,576,066	£4,667,608	£4,760,525	£4,854,835
Net Interest	-£22,950	-£33,358	-£25,570	-£34,381	-£42,573	-£29,483
Proportion	-0.52%	-0.74%	-0.56%	-0.74%	-0.89%	-0.61%
HRA						
Rent Income	11,682,330	12,285,102	12,719,119	13,096,610	13,522,249	13,961,722
Net Interest	£1,564,005	£1,559,413	£1,671,375	£1,781,686	£1,864,878	£1,948,288
Proportion	13.39%	12.69%	13.14%	13.60%	13.79%	13.95%

Cost of Servicing Debt (per year)	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Band D Council Tax	-£0.78	-£1.12	-£0.85	-£1.13	-£1.39	-£0.95
Per Council Dwelling	£520	£521	£559	£597	£626	£655

Usable Reserves	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
General Fund	4,492	4,155	3,637	3,014	2,161	1,057
Earmarked Reserves	3,526	3,049	2,634	2,320	1,920	1,895
HRA	2,114	1,917	1,910	2,027	2,027	2,027
Capital Receipts Reserve	1,997	2,062	1,592	892	517	392
TOTAL	**12,128**	**11,182**	**9,772**	**8,252**	**6,624**	**5,371**

Appendix 2

South Derbyshire
District Council

Treasury Management and Investment Strategy 2014/15

February 2014

1.0 Introduction

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Supplemented by a series of Prudential Indicators, this helps to consider the affordability and impact of capital expenditure decisions, together with the associated borrowing and investment.

1.2 The treasury service considers the effective funding of these decisions. It forms part of the process that ensures the Council achieves a balanced budget requirement under the Local Government Finance Act 1992.

1.3 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management).

1.4 The Council has adopted the Code and as a result, has adopted a Treasury Management Policy Statement. This Strategy and the associated Policy Statement were updates last year to reflect new requirements arising from the Localism Act 2011 and in particular, the move to self-financing for the Housing Revenue Account (April 2012).

1.5 On 28th March 2012, the Council took on £57,423,000 of debt significantly increasing the Councils debt. The Council is anticipating that no further borrowing will be required in 2014/15.

1.6 When taking on the debt for the HRA in March 2012 the majority of the debt was taken on with a fixed rate, however to ensure that we had a balanced portfolio one loan of £10million was taken on with a variable rate. Any significant changes to the forecast rate will be reported to the Council's Finance and Management Committee with the Strategy being reviewed and updated if necessary.

1.7 A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year.

1.8 This strategy covers:

- The management of debt
- The Council's debt and investment projections.
- The expected movement in interest rates.
- The Council's borrowing and investment strategies.
- Treasury performance indicators.
- Specific limits on treasury activities.
- Any local treasury issues.

2.0 Debt and Investment Projections

2.1 The table below shows the expected debt position of the Council over the Medium Term Financial Planning (MTFP) period.

External Debt	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Debt 1st April	58,763	58,458	58,450	58,450	58,450	58,450
New Debt	0	0	0	0	0	0
Maturing Debt	-305	-7	0	0	0	0
Debt 31st March	**58,458**	**58,450**	**58,450**	**58,450**	**58,450**	**58,450**
Annual Change in Debt	-305	-7	0	0	0	0
Long-term Investments	0	0	0	0	0	0
Short-term Investments	7,646	6,646	5,646	4,646	3,646	2,646

2.2 A comparison of this estimated debt position with the various borrowing limits is shown below.

Limits compared to Actual Debt	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Authorised Limit - General Fund	5,757	5,410	5,084	4,771	4,470	4,182
Authorised Limit - HRA	66,853	66,853	66,853	66,853	66,853	66,853
Financing Requirement	68,617	68,270	67,944	67,631	67,330	67,042
Operational Boundary	63,458	63,450	63,450	63,450	63,450	63,450
Gross Debt	58,458	58,450	58,450	58,450	58,450	58,450
Debt Less Investments	50,811	51,804	52,804	53,804	54,804	55,804

2.3 The above table shows that debt outstanding is expected to be comfortably below the Financing or underlying Borrowing Requirement (CFR) and well within the Authorised Limit or Cap.

2.4 The Operational Boundary allows a temporary borrowing requirement of £5m. However, it is expected that the Council will continue to be a net lender of funds on a day to day basis.

Management of Debt

2.5 As approved by the Finance and Management Committee on 23rd January 2012, the Council decided to adopt a “two pool” approach to debt management. This involves splitting borrowing between the General Fund and the HRA and then allocating new loans to each pool as required.

2.6 This has been adopted for clarity and transparency and ensured there was no detriment to the General Fund on transition to HRA self-financing. Treasury Management decisions on the structure and timing of borrowing will be made independently for the General Fund and HRA.

2.7 Interest on loans is calculated in accordance with proper accounting practice and allocated to either pool accordingly.

2.8 It is not anticipated that there will be a requirement to transfer loans between the two pools. If this is the case, then it will be need to be considered and approved separately.

Internal Borrowing

2.9 Both the HRA or General Fund are likely to have surplus cash balances which will allow either account to have external borrowing below its Capital Financing Requirement.

2.10 The interest earned will be attributable to the General Fund with a proportion allocated to the HRA based on the average rate of interest earned on cash balances during the year.

Use of Financial Instruments

2.11 The Council does not use any type of derivative instruments, such as interest rate swaps or hedge accounting, to manage the risk of borrowing.

General Fund Debt

2.12 The General Fund does not currently have any actual debt outstanding and its underlying borrowing requirement is financed from reserves and balances as follows:

General Fund - Net Indebtedness	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
CFR	5,757	5,410	5,084	4,771	4,470	4,182
Estimated Reserves	10,015	9,265	7,862	6,226	4,598	3,344
Net Indebtedness	**-4,257**	**-3,855**	**-2,779**	**-1,455**	**-128**	**838**

2.13 However, the table also shows that by 2017/18, the underlying indebtedness increases to a position where borrowing may apply. This will depend on overall cash flow and this is likely to be a temporary position. However, it will be kept under review.

HRA and Limit on Indebtedness

2.14 Under self-financing, the HRA pool operates within a cap over which no borrowing is allowed. This was prescribed by the Government and was set at £66,853,000.

2.15 The Cap is shown in the following table with a comparison to the CFR and expected level of actual debt on the HRA.

HRA Limit on Indebtedness	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
HRA Debt Cap	66,853	66,853	66,853	66,853	66,853	66,853
HRA CFR	62,860	62,860	62,860	62,860	62,860	62,860
Difference	3,993	3,993	3,993	3,993	3,993	3,993
HRA Debt	58,430	58,430	58,430	58,430	58,430	58,430
Borrowing Headroom	**8,423**	**8,423**	**8,423**	**8,423**	**8,423**	**8,423**

2.16 It is expected that the CFR and actual debt on the HRA will remain fairly flat over the majority of the current MTFP. However in 2017/18 it is planned we will start repaying the debt as detailed in the HRA business plan.

2.17 As the actual level of debt is below the Debt Cap, this creates headroom for further borrowing. Any additional borrowing would be undertaken within the affordability of the Business Plan and with committee approval.

Revenue Implications

2.18 The effect of the Council's expected debt management transactions have been included in the MTFP and are summarised in the following table.

Interest Payable and Receivable	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
General Fund						
Interest Payable	0	0	0	0	0	0
Interest Received	-23	-33	-26	-34	-43	-29
HRA						
Interest Payable	1,575	1,575	1,685	1,805	1,905	2,005
Interest Received	-11	-15	-13	-23	-40	-57

3.0 <u>Current Economic Outlook</u>

3.1 The UK economy started to show signs of recovery in 2013 with the first estimate of Q4 showing further 0.7% growth and 2.8% year on year.

3.2 The UK was downgraded by two of the 3 main credit rating organisations, with the third organization having the UK on a negative watch.

3.3 It is considered unlikely that interest rates will rise in the foreseeable future to force a rise in the price of money. The UK is still seen as a safe haven for investment and ensures that gilts (effectively the Government's cost of borrowing) remain low. This is the basis on which the PWLB fix their rates

Borrowing Strategy 2013/14 and Longer-Term Plan

4.1 For several years, the Council has not been required to enter into any form of long-term borrowing and in fact repaid all of its long-term Government debt in 2004. This was due to substantial capital receipts that the Council had generated, a significant proportion of which had been set-aside to repay debt in accordance with accounting regulations.

4.2 These receipts were placed on deposit and earned interest for the Council's revenue funds. In addition, these receipts have effectively been used to finance new capital expenditure and to meet the Council's shorter-term cash flow requirements when this was negative.

Existing Debt

4.3 The General Fund currently has not significant borrowing outstanding.

HRA Debt

4.4 The HRA has a one money market loan of £1m which was in existence prior to the HRA debt take-on. This is a fixed rate loan at 4.875%, maturing in 2032 with interest payments of £48,750 per year. The Council previously reimbursed a neighbouring authority for managing debt in respect of transferred assets.

4.5 The transferred debt was fully repaid in installments in 2013 following agreement with the neighbouring authority.

4.6 In March 2012 the Council debt position changed significantly with the HRA debt take-on of £57,423,000. £10,000,000 of this debt was variable rate and is forecast to be 0.70% for 2013/14. The remaining balance of the debt is all fixed rate. The maturity for the fixed and variable rate debt is due to mature periodically between 2022 and 2042. The HRA Business Plan allows for these repayments by generating resources from 2017/18.

4.7 The HRA debt will be reviewed regularly with treasury advisors to ensure we have the portfolio that best suits the Council.

Debt restructuring

4.8 This strategy will be kept under review and the Council has retained the services of Treasury Advisors to assist the Council. It is possible that the Council will be in a position to repay debt earlier and may also wish to reschedule some longer-term debt depending on future interest rates.

4.9 Although this is not anticipated over the current MTFP it will be kept under review. Any early repayment or rescheduling decision will be based on a Net Present Value calculation taking into account the relevant premium or discount.

Variable Rate Debt

4.10 As some of the debt is being borrowed at variable rates, this will be kept under closer scrutiny. This proportion of the portfolio (£10m) will be at around 0.7%. Allowance has been made in the Business Plan for this rate to increase to around 5% in future years.

Additional Borrowing

4.11 The Prudential System for Capital Finance provides flexibility for local authorities to borrow within their overall limit. Effectively, councils can borrow money as long as they are able to demonstrate that the associated interest and principal repayments are affordable and sustainable within their longer-term financial resources.

4.12 Additional borrowing can also be undertaken on an "invest to save" basis, i.e. the cost of loan finance is met from the payback of the investment (efficiencies, greater income, etc).

4.13 The Council's approved Capital Investment Strategy does not contain provision for any additional prudential borrowing. The investment programme will be financed from a mixture of external funding and capital receipts.

4.14 The HRA self-financing framework provides an opportunity for the Council to undertake additional borrowing as detailed in Section 2 (above). Although this is not anticipated over the current MTFP, it will be kept under review in accordance with the HRA Business Plan requirements.

Borrowing in Advance

4.15 The Council will only borrow in advance of need if it is felt that the benefits of borrowing at interest rates now, compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

4.16 In summary, the proposed borrowing strategy for 2014/15 is as follows:

- Meeting the Council's cash flow requirements, primarily through its Investment Strategy.
- Keeping under review the HRA debt pool and in particular the variable rate borrowing.
- Keeping under review the Net Indebtedness position on the General Fund Pool.
- Reviewing options for the outstanding money market loan of £1m.

Money Market Loan

4.17 Potentially, there is a break clause. The lender has the option of reviewing the interest rate at any time and increasing it if they so wish. However, the Council then has the option of rejecting this and can instead choose to repay without incurring any penalty.

4.18 The current strategy is that should the lender exercise their option to increase the interest rate and then the loan should be repaid at that time. It is proposed that this strategy continues to be adopted.

5.0 <u>Treasury Management Prudential Indicators and Limits on Activity</u>

5.1 There are four further treasury prudential indicators. The purpose of these 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.

5.2 However, if these are set too restrictively, they will impair the opportunities to reduce costs. The indicators are detailed in the following sections.

Upper limits on variable interest rate exposure

5.3 This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments. This is set at **5.2%** and is based on the affordability in the HRA Business Plan.

Upper limits on fixed interest rate exposure

5.4 This is set at **4.5%** and again is based on the affordability of the HRA Business Plan.

Maturity structure of Fixed Rate Borrowing

5.5 Based on the HRA debt take-on and the money market loan outstanding, the maturing structure is as follows:

Under 12 months	0%
12 months to 2 years	0%
2 years to 5 years	0%
5 years to 10 years	17%
10 years and above	83%

5.6 Although all fixed rate debt is expected to be repaid beyond 10 years, this is spread over a period up to a maximum of 29 years.

Total principal funds invested for greater than 364 days.

5.7 This indicator does not apply to the Council.

6.0 Investment Counterparty and Liquidity Framework

6.1 In accordance with Government Guidance, the primary principle governing the Council's investment criteria is the security and liquidity of its investments. Once that is achieved, then yield and length of investment are considered. The Council will also ensure that:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

Specified Investments

6.2 The purpose of specified investments is to identify investments offering high security and high liquidity. These investments should be in sterling and with a maturity of no more than a year. They are intended to be used with minimal procedural formalities. Any investments made with the UK Government, another local authority or parish council automatically counts as specified investments.

6.3 In addition, short-term investments with bodies or investment schemes with "high credit ratings" will count as specified investments. However, it is left to each authority to determine these institutions, and the Council must determine investment limits and how frequently these ratings are to be monitored.

Non-Specified Investments

6.4 Basically, these are all other investments not meeting the above criteria. Due to the fact that these investments could carry more risk than specified ones, the Council needs to set limits on these investments and determine guidelines on when they should be used.

6.5 The regulations make it clear that they do not wish to discourage authorities from using non-specified investments. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies that do not carry such a high credit rating.

Credit Quality

6.6 The credit worthiness of counterparties remains paramount in any investment decision and this is reflected in the approved lending policy and counterparty list. This is more important given the current economic situation and the credit risk in financial markets. This has seen many traditional "high street" financial institutions being downgraded in recent times.

6.7 The Council primarily relies on one of the 3 recognised credit rating agencies under the regulations, i.e. the “Fitch” IBCA rating to assess credit quality. Using this agency, the Council monitors the outlook or watch rating on an on-going and regular basis to determine whether the institution provides a safe investment.

6.8 Besides the use of the credit rating agency, the Council refers to the financial press, government support for banks and other market data. This is backed up by information and advice from the Council’s appointed Treasury Advisors.

6.9 Based on the core principles, the following strategy is adopted.

7.0 Investment Strategy 2014/15

7.1 The Council is expected to have a regular short-term investment requirement to enable it to manage its day-to-day financial affairs. There is no current proposal to enter into longer term and externally managed funds. Where the Council should need to borrow in advance of need, this strategy also applies.

7.2 The current approved investment list is based on best practice and is serving the short-term investment needs of the Council. It is kept under review and will be updated in line with the Treasury Management Policy Statement if and when necessary.

7.3 The approved lending list and policy is shown at **Appendix 3.** In accordance with regulations, it sets out where the Council will invest surplus funds and places limits upon the various institutions.

7.4 A summary is shown in the following table.

Institution	Limit
Specified Investments • UK Debt Management Office (DMO) • Local, Police, Fire and Parish Authorities • Other Bodies with a High Credit Rating of F1+/AA-	 £15m £5m £7.5m
Non-Specified Investments • F1/AA Rated Bodies – First Call • F1/A Rated Bodies – Second Call • F2/A Rated Bodies – Third Call	 £2m £2m £0.25m

Definition of Credit Ratings

7.5 The long-term rating is based on an investment grade categorised by "Fitch" on the following scale.

AAA: the best quality companies, reliable and stable
AA: quality companies, a bit higher risk than AAA
A: economic situation can affect finance
BBB: medium class companies which are satisfactory at the moment.

7.6 Intermediate modifiers are also used for each category between AAA and BBB (i.e. AA+, AA, AA-, A+, A, A-, etc.).

7.7 Short-term credit ratings indicate the potential level of default within a 12-month period, based on the following scale.

F1+: best quality grade, indicating exceptionally strong capacity to meet financial commitments.
F1: best grade, indicating strong capacity to financial commitments.
F2: good quality grade with satisfactory capacity to financial commitments.

7.8 The scale then falls from F3 to B, then C and finally down to D, which indicates the institution is likely to, or as failed to meet its financial commitments.

General Policy

7.9 As approved, priority is given to specified investments in any investment decision. The length of investment is made in accordance with overall cash flow requirements.

7.10 The Council's policy is to seek investments with those institutions graded at least AA and F1+. The policy is to focus on the credit quality of investment counterparties rather than amounts invested and returns.

Use of Non-Specified Investments

7.11 This generally covers high street financial institutions (banks and building societies) and the merchant or secondary-banking sector. It is proposed that these are only used as a “lender of last resort” and in the order listed in the above table.

7.12 In particular this may be the case where limits on specified investments are likely to be exceeded and where there is a temporary need to place money.

7.13 It should be noted that F1 and F2 credit ratings are still considered to be fairly high ratings for short-term deposits.

7.14 These banks are seen as being safe to invest with advice from the Treasury. Therefore, as non-specified investments, these will be utilised when other limits are reached and have a limit of £1million. Instant access accounts mean we are able to withdraw funds at any time if the financial situation of these institutions was to change.

Use of Treasury Advisors

7.15 The Council uses a firm of advisors on a retained basis. Their role is to provide market analysis and advice, together with literature and updates on key treasury management developments. They do not offer any of their own or 3rd party products/instruments for borrowing or investing.

7.16 They also provide training workshops and seminars. They are appointed through the Council’s procurement framework.

Performance Indicators

7.17 The main indicator is for the return on short-term investments to, average over the year, the Market 7-Day Rate, this being a standard measure of performance. Performance in recent years is shown in the following table.

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
7-Day Rate (target)	4.82%	5.61%	3.57%	0.39%	0.51%	0.62%	0.51
Actual Rate	4.86%	5.81%	4.38%	0.72%	0.78%	0.32%	0.31%

APPENDIX 3

APPROVED LENDING LIST & POLICY

1. Approved Types of Investment

The Council may use the following types of investment when managing funds:

- Fixed Term Deposits
- On Call Deposits

2. Approved Institutions for Investment

The Council may invest surplus cash with the following institutions, subject to the provisions within the investment policy in 3 below:

- UK Debt Management Office (DMO);
- Local Authorities and Police Authorities within the UK;
- Major clearing banks incorporated in the UK and their subsidiaries (use of non-British banks is subject to the assessment and approval of the Chief Finance Officer)**;**
- UK Building Societies;
- British Merchant Banks and Securities House Association members;
- The secondary banking sector (use of non-British banks is subject to the assessment and approval of the Chief Finance Officer).
- Foreign Banks with an F1+ Rating (subject to the assessment and approval of the Chief Finance Officer).

3. Investment Policy

The following limits apply on the amount of money that can be invested with any one institution mentioned above, by the designated officers:

• UK Debt Management Office (DMO)	£15M
• Highest quality financial institutions	£7.5M
• Local authorities and police authorities	£5M
• 100% owned subsidiaries of clearing banks	£2M
• F1/AA rated building societies	£2M
• F1/A rated building societies	£1M
• Unrated building societies	£1M
• F1 /A rated merchant or secondary banks	£2M
• F2/A rated merchant or secondary banks	£0.25M

NOTE

- The highest quality financial institutions must have a minimum short-term "Fitch" IBCA rating of F1+ and a long-term rating of AA.