ASSEMBLY

22 FEBRUARY 2012

Title: Treasury Management Strategy Statement 2012/13	
Report of the Cabinet Member for Finance and Education	
Open Report	**For Decision**
Wards Affected: All	**Key Decision: Yes**
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Accountable Director: Tracie Evans, Corporate Director – Finance and Resources	

Summary:

This report deals with the Treasury Management Annual Investment Strategy Statement, Treasury and Prudential Indicators, Annual Investment Strategy and borrowing limits, in compliance under section 15 (1) (a) of the Local Government Act 2003.

The production and approval of a Treasury Management Annual Strategy Statement and Annual Investment Strategy are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year.

The Local Government Act 2003 also requires the Council to have regard to the Prudential Code, and to set prudential indicators which take into account the Council's capital investment plans for the next 3 years.

The Cabinet considered this report at its meeting on 14 February 2012 and endorsed the recommendations below.

Recommendation(s)

Assembly is recommended to approve the Treasury Management Strategy Statement for 2012/13 as attached at **Appendix 1** and, in doing so, agree the following:

a. The current treasury position for 2011/12 and prospects for interest rates (Appendix 1 section 3 and 4);
b. The revised Authorised borrowing limit (General Fund and HRA) of £465m for 2011/12, which includes £265m for the HRA self-financing debt settlement and £55m estimated borrowing to finance the 2011/12 capital programme;
c. The Borrowing Strategy, Debt Rescheduling Strategy and Policy on borrowing in advance of need for 2012/13 (Appendix 1 section 6), including the Housing

Reform and effects on treasury management of Housing Revenue Account reform; d. The Minimum Revenue Policy Statement for 2012/13 which sets out the Council's policy on repayment of debt (Appendix 1 section 10); e. The Authorised borrowing limit (General Fund and HRA) of £528m for 2012/13, which will be the statutory limit determined by the Council, pursuant to section 3(1) of the Local Government Act 2003 (Appendix 1A); f. The Treasury Management Indicators and Prudential Indicators for 2012/13 (Appendix 1A); and g. The Annual Investment Strategy and creditworthiness policy for 2012/13 (Appendix 1B), which outlines the investments that the Council may use for the prudent management of its investment balances.
Reason(s) It is necessary for the Assembly to approve this report due to the requirements of the Local Government Act 2003.

1. Introduction and Background

1.1 This report gives a brief explanation of the key elements of the Council's Treasury Management Strategy 2012/13, which is set out in detail in Appendix 1 to this report. The Council is statutorily required to approve the Strategy prior to the new financial year.

1.2 The key elements of the Strategy relate to the following:

- Investment Strategy – relating to the management of the Council's cash balances.
- Borrowing Strategy – relating to the financing of the Council's capital programme.

1.3 The report also summarises proposed changes to strategy from last year.

2. Proposal and Issues

2.1 Investment Strategy

Cash Management

2.1.1 The Council has cash balances arising from its operational activities, i.e. sources of income such as grants and Council Tax are received during the year and this is offset by daily expenditure to run services. Due to the timing of these cash inflows and outflows a surplus of cash is available at any point in time for investing. This is because in general significant sources of income for the year such as grants are receipted in advance of expenditure, plus the Council also holds specific reserves for future expenditure plans.

2.1.2 Cash balances are also affected by "working capital", which relates to amounts of outstanding payments to be made to suppliers (accounts payable) offset by amounts owed to the Council (accounts receivable). Cash balances are higher when the level of accounts payable is greater than accounts receivable, because the Council has incurred net expenditure in accounting terms which has not been paid for in cash terms.

2.1.3 At the financial year end (31st March) the level of the Council's cash balances in recent years have been as follows:

2010/11 - £94m
2009/10 - £116m
2008/09 - £125m

2.1.4 These balances have been made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund and HRA Fund balances;
- Earmarked Reserves;
- Capital Receipts;
- Provisions;
- Loans from Public Works Loan Board and banks to fund capital expenditure but not yet spent;
- Working Capital.

2.1.5 At the end of December 2011, the Council's cash balances totalled £91m and were invested as follows:

Bank / Counterparty	**£m**
Internally Managed:	
Lloyds TSB Group	14.9
Santander Group	10.5
Barclays	14.9
Nationwide Building Society	11.0
External Fund Managers:	
Investec Asset Management	28.7
Scottish Widows	11.5
Total	**91.5**

2.2 Changes to Investment Strategy

2.2.1 The Council's investments are managed on the following principles, in order of priority:

- Security – minimising the risk of losing cash arising from a bank failure and consequent default (as occurred with Icelandic Banks with numerous local authorities in 2008).
- Liquidity – ensuring the Council will have access to cash as required to meet daily expenditure obligations.
- Yield – after ensuring the above are met, the Council will aim to maximise interest earnings on cash invested.

2.21 With the above principles in mind the following changes to investment strategy are recommended:

- The financial markets have been severely affected by the Eurozone crisis, with increasing credit risk for banks in the Eurozone area and risk of contagion. It is therefore proposed to limit investments to UK banks until there is a satisfactory resolution to the crisis.

- The reduced number of available counterparties for investing arising from the Eurozone crisis means that it is necessary to increase counterparty limits for UK banks, in order to give the Council more headroom for investing funds. It is recommended to increase the counterparty investment limit from £15m to £30m for Lloyds TSB and Royal Bank of Scotland for each counterparty, as these banks are government supported and therefore do not represent a significant credit risk. This will also give the Council more ability to increase yields when opportunities arise for deals at relatively attractive interest rates.

- It is proposed to invest in high credit quality corporate bonds for longer term investments, in order to increase yields whilst restricting exposure to highly rated institutions. In particular, AAA rated multilateral development banks such as European Investment Bank offer competitive rates. Bond purchases would be limited to £10m per counterparty to limit exposures and manage overall liquidity of Council's investments.

- It is also proposed not to use derivative financial products due to potential losses arising from instability in the financial markets at this time.

2.3 **Borrowing Strategy**

2.3.1 The Council is allowed to borrow funds from the capital markets for two purposes:

(i) Short term temporary borrowing for day to day cash flow purposes to ensure liquidity. This is likeliest to occur towards the end of the financial year when the Council's cash balances are lowest and Council's own cash may be tied up in longer term investments.

(ii) Long term borrowing to finance the capital programme where the Council can demonstrate the borrowing is affordable. The Council receives external funding (e.g. grants, TfL contributions etc) to meet a large proportion of its capital expenditure but some projects do not attract specific funding. These projects have to be funded by the Council from sources such as capital receipts from the sale of property. However in recent years the Council has not had these funds available and therefore has had to borrow.

2.3.2 The Council's borrowing as at 31 March 2011 is made up of three elements:

a) External loans from Public Works Loan Board and private banks - £70m
b) PFI/finance lease liabilities - £36m
c) "Internal" borrowing - £46m.

Internal Borrowing

2.3.3 Internal borrowing represents the use of surplus available cash balances to pay for capital spend, rather than undertaking new external loans. The Council will use internal cash balances by reducing investments when deposit rates on investments are lower than interest rates on new loans. This is because the lost interest earnings on reduced cash balances are cheaper than increased interest payable on a new external loan. This in part explains why the Council's cash balances have reduced since 2008/09.

2.3.4 Capital expenditure for 2011/12 to be financed from borrowing is forecast to be approximately £55m and it is proposed that this is met from internal cash balances except £7.8m for the HRA to be financed from a PWLB loan. The impact of this is to further reduce investments which are forecast to be approximately £46m by end of the financial year.

2.3.5 This diminution in cash to finance capital expenditure means borrowing for financing the capital programme in future years may require undertaking new external loans to maintain liquidity. However whilst borrowing rates remain higher than deposit rates, the Council will seek to delay new loans as long as possible, whilst monitoring latest interest rate forecasts to ensure any new loans are undertaken before base rate rises. The borrowing forecast for 2012/13 capital expenditure is currently £47m. The impact of this on debt charges is, however, already built in to the Council's revenue budget.

Repayment of Borrowing

2.3.6 The Council's external borrowings are all loans where the principal is repaid at maturity. Loans due for repayment in forthcoming years can be refinanced with a new loan if the interest rate is affordable. Otherwise the principal repayment will require to be financed from revenue or generating capital receipts.

2.3.7 Internal borrowing can be also be reduced by generating capital receipts, which will replenish cash balances and in accounting terms be used for financing historic spend rather than for new capital projects.

HRA Self Financing

2.3.8 The changes to the HRA regime and the introduction of self financing has resulted in the Council requiring to undertake a £265m loan to pay the DCLG as part of the settlement. This loan will be from the PWLB where annual payments will be interest only and principal only to be repaid at maturity. The annual interest costs of £9.7m are factored into the HRA Business Plan.

Minimum Revenue Provision

2.3.9 In addition to interest payable costs, the Council is required to make a statutory accounting provision for the repayment of debt on its General Fund borrowings, called Minimum Revenue Provision (MRP). MRP is not a statutory requirement for HRA borrowings however. The Council's MRP policy is included in the Treasury Management Strategy.

2.3.10 MRP costs are rising as the Council's borrowing increases, however these costs are contained within the approved revenue budget.

3. Financial Implications

3.1 The financial implications have been discussed in detail in earlier sections of this report.

4. Legal Implications

4.1 Implications completed by: Doreen Reeves, Legal Group Manager

4.2 This report is in accordance with Section 15(1) of the Local Government Act 2003. It is a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year.

5. Other Implications

5.1 **Risk Management** - This report has risk management issues for the Council, primarily that a counterparty could cease trading or risk that interest rates would fall adversely. The mitigation of these is contained in this report.

Background Papers Used in the Preparation of the Report:

- Local Government Act 2003
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities
- CIPFA – Revised Treasury Management in the Public Services
- Budget Framework Report 2012/13
- HRA Business Plan v7 (16 Jan 2012)
- "Treasury Management Strategy Statement 2012/13" report and minute, Cabinet 14 February 2012

List of appendices:

Appendix 1 – Treasury Management Strategy 2012/13
Appendix 1A – Prudential and Treasury Indicators 2012/13 – 2014/15
Appendix 1B – Investment Criteria
Appendix 1C – Approved Countries list
Appendix 1D – Sector's interest rate forecast
Appendix 1E – Sector's economic view