ASSEMBLY

24 February 2015

Title: Treasury Management Strategy Statement 2015/16	
Report of the Cabinet Member for Finance	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
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Summary

This report deals with the Treasury Management Annual Strategy Statement, Treasury and Prudential Indicators, Annual Investment Strategy and borrowing limits, in compliance with 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 three years.

The Cabinet is to consider this report at its meeting on 16 February 2015. Any issues arising from the Cabinet's consideration will be reported at the meeting.

Recommendation(s)

The Assembly is recommended to:

(i) Note that on 15 January 2015 the Council borrowed £89 million from the European Investment Bank as outlined in section 4.5 of the report;

(ii) Adopt the Treasury Management Strategy Statement for 2015/16 as set out in the report and in doing so:

(a) Note the current treasury position for 2015/16 and prospects for interest rates, as referred to in sections 4 and 7 of the report;

(b) Approve the Council's Borrowing Strategy, Debt Rescheduling Strategy and Policy on borrowing in advance of need for 2015/16 as referred to in section 9 of the report;

(c) Approve the Annual Investment Strategy and Creditworthiness Policy for 2015/16 outlining the investments that the Council may use for the prudent management of its investment balances, as set out in Appendix 1 to the report;

(d) Approve the Authorised Borrowing Limit of £800m for 2015/16, representing the statutory limit determined by the Council pursuant to section 3(1) of the Local Government Act 2003, as set out in Appendix 3 to the report;

(e) Approve the Treasury Management Indicators and Prudential Indicators for 2015/16, as set out in Appendix 3 to the report;

(f) Approve the Minimum Revenue Policy Statement for 2015/16, representing the Council's policy on repayment of debt, as set out in Appendix 4 to the report;

(g) Maintain the authority delegated to the Chief Finance Officer, in consultation with the Cabinet Member for Finance, to proportionally amend the counterparty lending limits agreed within the TMSS to take into account the initial increase in cash from the EIB but also the subsequent decrease in cash balances as payments are made to the SPV; and

(h) Agree that the delegated responsibility be reviewed as part of the 2014/15 Treasury Management Outturn Report to Assembly in July 2015.

Reason(s)

To enable the Council to accord with the requirements of the Local Government Act 2003.

1. Introduction and Background

1.1 The Council is required to operate a balanced budget, with cash raised during the year sufficient to meet the Council's cash expenditure. Treasury management supports the Council by seeking to ensure its cash flow is adequately planned, with cash being available when it is needed. Surplus cash is invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate security and liquidity before considering an investment return.

1.2 A second function of treasury management is funding the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

1.3 The Council is responsible for its treasury decisions, activity and risk appetite. The successful identification, monitoring and control of risk are integral elements of treasury management, including credit and counterparty risk, liquidity risk, market risk, interest risk, refinancing risk and legal and regulatory risk. The Council is statutorily required to approve the TMSS prior to the new financial year.

2. Reporting Requirements

2.1 The Council is also required to receive and approve at least three main treasury reports each year. These reports are required to be adequately scrutinised by Committee before being recommended to the Council. The three main treasury reports are:

i. **The Treasury Management Strategy Statement (TMSS)** is the most important report and takes into account the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators (PIs) and the outlook for interest rates. In addition the current market conditions are factored into any decision making process.

ii. **An Annual Treasury Report** which outlines the actual PIs, treasury indicators and treasury operations compared to the estimates within the strategy.

iii. **A Mid-Year Treasury Management Report** to update Members on the progress of the capital position, amending PIs and investment strategy as necessary.

2.2 As the Council is responsible for housing, PIs relating to capital expenditure, financing costs and the Capital Financing Requirement (CFR) are split between the Housing Revenue Account (HRA) and the General Fund (GF). The impact of new capital investment decisions on housing rents will also need to be considered.

2.3 This report provides an explanation of the key elements of the Council's Treasury Management Strategy, its Minimum Revenue Provision (MRP) Strategy, the Annual Investment Strategy (AIS) for 2015/16 and the borrowing strategy, which are set out in detail in the appendices attached to this report.

3. Treasury Management Strategy for 2015/16

3.1 The Local Government Act 2003 and supporting regulations require the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years and ensure the Council's capital programme is affordable, prudent and sustainable.

3.2 The Act requires councils to set out their treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by investment guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.3 The Department of Communities and Local Government (DCLG) has issued revised investment guidance that came into effect from 1 April 2010, and the Council has adopted the recommendations of the guidance. The strategy for 2015/16 covers two main areas:

Treasury Management Issues

- Treasury Management Advisors;
- Current Portfolio Position;

- The use of the Council's Resources and expected investment balances;
- Economic Update;
- The Annual Investment Strategy and Investment Policies;
- The Capital Expenditure Plans 2015/16 – 2017/18;
- The Council's Borrowing Strategy and Borrowing Requirement; and
- Treasury indicators which limit the treasury risk and activities of the Council.

Capital Issues

- The capital plans and the prudential indicators; and
- The minimum revenue provision (MRP) strategy.

4. Current Treasury Position

4.1 The Council holds cash balances arising from its operational activities, including income such as grants and Council Tax, which are offset by daily expenditure to run services. Due to the timing of these cash flows, 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 received in advance of expenditure and as the Council holds specific reserves for future expenditure plans. Cash balances are also affected by "working capital", which relates to amounts of outstanding payments to be made to suppliers offset by amounts owed to the Council.

4.2 The Council's year-end (31 March) cash balances since 2012/13 are shown below:

2014/15 - £210m*
2013/14 - £120m
2012/13 - £110m
** estimate includes £89m European Investment Bank Borrowing.*

4.3 These balances are made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund, Housing Revenue Account and School cash balances;
- Earmarked Reserves and provisions;
- Capital Receipts and working Capital; and
- Public Works Loan Board and bank loans to fund capital expenditure.

4.4 Table 1 below shows the Council's investments and borrowing balances as at 31 December 2014, including the average life and the Rate of Return.

Table 1: Council's treasury position at 31 December 2014

	Principal Outstanding 31/12/14 £'000s	Average Rate of Return 31/12/14 %	Average Life as at 31/12/14 (yrs)
Fixed Rate Funding			
PWLB	265,912	3.50	41.06
Market	40,000	4.00	53.86
Short Term Borrowing	19,800	0.43	0.07
Total Debt	**325,712**	**3.37**	**40.14**

Investments (In-House)			
Federated Money Market Fund	2,000	0.45	N/A
Goldman Sachs Bank	10,000	0.77	0.14
Standard Chartered Bank	10,000	0.95	0.64
Lloyds Banking Group	49,500	0.97	0.47
Local Authorities	27,000	1.08	0.90
Royal Bank of Scotland	35,000	1.34	1.34
Barking Riverside Limited	4,626	3.50	5.25
Total Investments	**138,126**	**1.15**	**0.92**
Net Borrowing	**219,912**		

4.5 European Investment Bank

4.5.1 At the Cabinet Meeting of 4 August 2014 and the Assembly meeting of 17 September 2014, Members agreed to fund the regeneration of Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 using borrowing from the European Investment Bank (EIB) as the rates offered were significantly below rates that could be obtained from other sources including banks and the Public Works Loan Board (PWLB).

4.5.2 Members also agreed to delegate authority to the Head of Legal Democratic Services, or an authorised delegate, to execute all legal agreements, contracts and other documents on behalf of the Council in relation to Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 Funding Proposals and the borrowing of £89 million from EIB.

4.5.3 On 15 January, following a large drop in the 30 Year UK Gilt rate, the Chief Finance Officer (CFO) agreed to fix the full £89 million borrowing with the EIB over a 30 year period. The rate agreed was 2.207%, which is significantly below the rates originally modelled that made the regeneration of Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2 a viable option.

4.5.4 The full £89 million was paid across to the Council by the EIB on 30 January 2015. To accommodate the increased borrowing and the increase in cash available to invest, Members agreed to delegate authority to the CFO, in consultation with the Cabinet Member for Finance, to approve appropriate amendments to the authorised and operational borrowing limits and proportionally amend the counterparty lending limits within the TMSS. The amended TMSS counterparty limits are reflected in this report.

4.6 Treasury Position at 31 March 2014

4.6.1 The Council's treasury portfolio position at 31 March 2014, with forward projections are summarised in table 2. The table shows the actual external debt against the underlying capital borrowing need (CFR), highlighting any over or under borrowing.

4.6.2 The CFR in table 2 does not contain the costs for Reside. The accounting requirements for Reside are in the process of being finalised but the initial view is that Reside will reported separately from the Council's main accounts and will not be included within the Council's CFR.

Table 2: Treasury Position at 31 March 2014, with forward projections

£'000s	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
External Debt					
Debt at 1 April	325,912	315,912	394,912	404,912	404,912
Expected change in Debt	(10,000)	79,000	10,000	0	0
Other long-term liabilities	60,844	58,192	55,473	52,650	49,723
Gross debt at 31 March	**376,756**	**453,104**	**460,385**	**457,562**	**454,635**
CFR	**484,743**	**513,780**	**529,424**	**551,690**	**555,303**
Under / (over) borrowing	**107,987**	**60,676**	**69,039**	**94,128**	**100,668**

4.7 **Medium term capital finance budget**

4.7.1 A key part of the Council's budget strategy is the medium term capital finance budget shown as Table 3. It is a statutory requirement that the level of borrowing is kept under review and is affordable.

Table 3: Medium term capital finance budget

£'000s	2014/15 Budget	2015/16 Budget	2016/17 Budget	2017/18 Budget
Interest Payable and MRP	14,731	11,893	10,803	13,725
Investment Income	(647)	(1,539)	(1,997)	(2,247)
Net Cost	**14,232**	**11,310**	**9,735**	**12,684**

5. Treasury Management Advisors

5.1 The Council uses Capita Asset Services (CAS) for external treasury advice. However the Council recognises that it is ultimately responsibility for all treasury management decisions and will ensure that undue reliance is not placed on the external advisors.

5.2 The Council recognises that there is some value in receiving advice from external treasury advisor in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are documented, and subjected to regular review. For its cash flow generated balances, the Council will utilise a range of investment instruments, as agreed within the Annual Investment Strategy restrictions (appendix 1) in order to benefit from the compounding of interest.

6. Economic Update

6.1 In the **United Kingdom** the strong GDP growth experienced in 2013 continued into 2014, with quarterly growth of 0.7% in Q1, 0.9% in Q2 and 0.7% in Q3 2014. Forecasts indicate growth will continue into 2015, with encouraging forward surveys for the services, manufacturing and construction sector and also for business investment. For this recovery to become more balanced and sustainable the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting and the manufacture of goods, both of which need to substantially improve on their recent lacklustre performance.

Unemployment fell to 6% in November 2014 and is expected to continue its downward trend. This may feed through to increases in pay rates at some point over the next three years, although the effect future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence are areas that need to be regularly reviewed. Consumer Price Index (CPI) fell to 1% in November 2014 following four years of being above the MPC's 2% target.

Overall markets expect the MPC will be cautious in raising rates to protect indebted consumers at a time when inflationary pressures are weak. An increase in Base Rate of 0.25% is forecast for Q2 2015, with subsequent increases likely to be small.

6.2 The **Eurozone (EZ)** continues to experience weak growth and the potential of deflation, with a November's inflation rate of 0.3% and with some EU countries experiencing negative inflation rates. The European Central Bank (ECB) initially took limited action to loosen monetary policy to promote growth, including cutting its benchmark rate to 0.05% and its deposit rate to (0.2%) and started a programme of purchasing corporate debt. On 22 January the ECB announced that it would introduce Quantitative Easing (purchase of sovereign debt) but it is too early to tell what effect this will have on the Euro and borrowing costs of the smaller EU countries. There remain concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. Any loss of market confidence in the two largest Eurozone economies, after Germany, would present a huge challenge to the resources of the ECB.

6.3 In the **USA** the Federal Reserve (the Fed) ended its asset purchase programme in October 2014 signalling confidence in the US economic recovery. Poor first quarter 2014 GDP figures were due to bad winter weather but were followed by strong Q2 and Q3 growth figures. As a result of consistent growth, cuts in government expenditure and tax rises, the annual US government deficit has been halved from its peak without appearing to do too much damage to growth. However weak labour force participation remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions. It is currently expected that the Fed will start increasing rates in mid 2015.

7. The Annual Investment Strategy and Investment Policies

7.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

7.2 These guidelines do not apply to either trust funds or pension funds, which operate under a different regulatory regime. The key intention of the guidance is to maintain the current requirement for councils to invest prudently. The Council's investment priorities are:

i. **Security** of the investment capital: Minimising the risk of losing cash arising from a bank failure and consequent default (as occurred with Icelandic Banks in 2008).

ii. **liquidity** of the investment capital: Ensuring the Council will have access to cash as required to meet daily expenditure obligations.

iii. **An optimum yield** which is commensurate with security and liquidity: After ensuring the security and liquidity priorities are met, the Council will aim to maximise interest earnings on cash invested.

7.3 The Annual Investment Strategy (AIS) is attached Appendix 1 of this report. It is the Council's responsibility to agree an appropriate minimum acceptable credit quality of counterparties for inclusion on the lending list in the AIS in accordance with the above principles. A creditworthiness methodology has been used to create the counterparty list, which takes into account the ratings and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agency. Using the CAS ratings service, banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Withdrawal of Implied Sovereign Support

7.4 As part of regulation changes within the banking sector the UK Government will remove the expectation that governments will support financial institutions in the event of an institution fail. This move is to set aside a structure that will be followed should a financial institution fail. To do this the UK Government has agreed a process to deal with a financial institution failure, which includes the option for institutional investors to lose part of their invested cash as part of a "bail in".

7.5 It could be argued that the potential for institutional investors to lose part of their investment has always been there and is the main driver behind the rates "rewarded" when an investment is made. The structure to be adopted does still keep the equity investor and bond holders at the top with Institutional Investors after these. Therefore there is a significant buffer before the Council's cash holdings would be affected.

7.6 One area of concern is the potential for the rating agencies to downgrade the banks the Council currently is invested with due to the loss of the implied government support. This potentially would bring them below the minimum credit rating agreed by the Council in the 2014/15 TMSS. As a result, where the credit rating is taken into account, it is recommended that the minimum credit rating criteria be revised from A / F1 to A- F2. This change is reflected in the Annual Investment Strategy (Appendix 1).

7.7 The Council recognises that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment takes account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as Credit Default Swaps and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, CAS.

7.8 Other information sources used will include the financial press and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

7.9 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and to minimise risk.

7.10 Historically the Council has maintained a prudent and low risk treasury investment strategy. This approach has ensured that the Council has not lost money from any of its investments, while achieving a return commensurate with the risk taken. This approach has lead to treasury having a significant impact on the Council's overall funding requirements, both in terms of generating income from investments and from reducing the costs of borrowing to support the Council's capital programme.

7.11 In order for Treasury to support the significant savings target the Council has for 2015/16 to 2017/18, Members have agreed a number of savings targets for treasury as outlined in table 4 below:

Table 4: Treasury Savings Targets for 2015/16 to 2017/18

Saving Reference	Savings Proposal	2015/16 £000	2016/17 £000	2017/18 £000	Total £000
CEX/SAV/27	Increase in Average Return as Rates Rise	500	500	250	1,250
CEX/SAV/29	Increase Counterparty Risk	250	-	-	250
CEX/SAV/54e	Increase Duration Risk	100	-	-	100
	Total Savings	**850**	**500**	**250**	**1,600**

7.12 To achieve the interest target the treasury section needs to achieve the following average returns on an estimated average cash balance of £140m:

2015/16	1.25%
2016/17	1.70%
2017/18	1.90%

7.13 The increased return is heavily reliant on interest rates increasing from their current near historic lows. The increase does not need to occur in the first half of 2015 as treasury has secured a return through longer dated investments, which should achieve the 1.25% return for 2015/16. However if rates do not increase in the second half of 2015 then the return targets will be difficult to achieve without significantly increasing either the duration risk and / or the counterparty risk.

Interest Rate Forecast: UK

7.14 Interest rate forecasting remains difficult with many external influences weighing on the UK. The overall longer term trend is for gilt yields to rise as an increase in confidence in world economic recovery encourages investors to switch from bonds to equities. The overall balance of risks to economic recovery in the UK is currently evenly weighted. However time will tell just how long this period of strong economic growth will last. Downside risks currently include:

i. A weak rebalancing of UK growth to exporting and business investment.
ii. Weak growth in the UK's main trading partners.
iii. A resurgence of the Eurozone sovereign debt crisis.
iv. Heightened political risks.
v. The reluctance of western central banks to raise interest rates plus the size of the QE stimulus has created potentially unstable flows of liquidity searching for yield (this is similar to one of the issues which led to the 2008 financial crisis).

7.15 The potential for upside risks to UK gilt yields include:

i. A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds into equities; and
ii. UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

7.16 Although there are potentially more downside risks compared to upside risks, the generally view among economists is that rates will increase in 2015 and therefore the treasury investment strategy for 2015/16 has been set with only a minimum increase in proposed risk.

7.17 The changes in investment strategy compared to the 2014/15 TMSS include:

i. **Duration Risk**: Generally the longer the duration of an investment the better the return. There are a number of risks associated with this including:

- the risk of locking in a low rate for a long period; and
- liquidity risks as the cash will not be available for the Council to use.

To achieve the interest income budget set, without taking significant risk the treasury section has sought to increase the duration of a number of investments during 2013/14 and 2014/15 where opportunities have arisen to do so. This strategy will continue in 2015/16, although the benefit from higher returns will be weighed against the risk of locking in investments at low rates at a time when there is a view that interest rates will begin to increase. In addition, in order to reduce the liquidity risk a limit of £100m has been set for investments with a duration in excess of one year at any one time.

ii. **Counterparty Risk:** During 2015/16 the Council will continue to use the creditworthiness service provided by its advisor, Capita Asset Services, which employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments and are outlined in detail in Appendix 1 section 16.

The financial institutions the Council invests with all have credit ratings and as a general rule, the lower the credit rating the higher the return. The Council has historically had a prudent, although not completely risk adverse, approach to treasury investments.

The Council has agreed that in order to increase investment income treasury will be able to take additional risk. The additional risk proposed includes:

1. Increase the one year Lloyds limit from £50m to £80m.
2. Increase the RBS limit for deals from £35m to £50m.
3. Increase the bank certificate of deposit (CD) counterparty limit over one year from £20m to £30m.
4. Increase the total Local Authority Limit over one year from £40m to £50m.
5. The minimum credit rating criteria be revised from A / F1 to A- F2.

HRA Investments

7.18 Cash balances held by the HRA will be invested as part of the Council's overall treasury strategy. Cash balances will generally earn the average rate of the Council's investments, which will be calculated at the financial year end.

7.19 Where there is agreement between the CFO and the Director of Housing, individual investments can be ring-fenced for the HRA, with the allocations made within the Council's overall treasury strategy requirements. Further details are set out in the HRA Business Plan.

Derivatives

7.20 The use of derivative financial products will continue to be excluded from the strategy.

8. The Capital Expenditure Plans 2015/16 – 2017/18

8.1 The Council's Housing and General Fund capital expenditure plans, together with Balances and Reserves, are the key drivers of treasury management activity. The estimates for Capital expenditure, and its funding based on current proposed Revenue Budget and Capital Programmes, are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans. The Prudential Indicators are included in Appendix 1A of this report.

8.2 Table 5 below shows the proposed capital expenditure over the coming three financial years. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and, in the case of the HRA, housing rent levels.

Table 5: Proposed Capital Expenditure 2015 to 2018

Capital expenditure	2013/14 Actual £000	2014/15 Approved £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000
General Fund	51,726	86,939	99,446	50,809	13,088
HRA	71,087	90,439	81,041	64,933	57,003
Total	**122,813**	**177,378**	**180,487**	**115,742**	**70,091**
Financed by:					
Capital Grants	50,604	51,772	90,444	26,540	0
Section 106	889	1,074	0	0	0
Revenue Contributions	9,249	4,703	400	0	0
Capital Receipts	15,960	26,352	21,195	19,530	14,830
HRA Contributions	42,656	55,209	43,161	35,853	42,173
Sub-Total	**119,358**	**139,110**	**155,200**	**81,923**	**57,003**
Net financing need for the year	**3,455**	**38,268**	**25,287**	**33,819**	**13,088**

8.3 The estimated financing need for the year in Table 5 represents a shortfall of resources resulting in a requirement to borrow. This underlying need to borrow is the CFR. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

8.4 **Other long term liabilities:** the above financing need excludes other long term liabilities, such as PFI, Reside and leasing arrangements, which already include borrowing instruments. The Abbey Road phase 2 and Gascoigne (East) phase 1 regeneration have been included as the Council borrowed directly from EIB and will manage the funding of the Special Purpose Vehicle used to manage their regeneration.

8.5 Sufficient headroom has been provided within the Authorised Limit on external borrowing to ensure that any major capital investment projects where finance has yet to be finalised, are not restricted by this statutory limit. The limit covers any short term borrowing for cash flow purposes as well as long term borrowing for capital projects, finance leases PFI initiatives as well as any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.

8.6 In addition sufficient headroom has been included within the Operational Boundary and Authorised Limit if it is necessary for the costs of Reside to be included within the CFR. The estimated additional costs and subsequent increase in the CFR if Reside were included would be an estimated £220m, although the structure would mean that no additional long term borrowing would be required.

9. The Council’s Borrowing Strategy and Borrowing Requirement

9.1 The decision to borrow is a treasury management decision and is taken by the CFO under delegated powers of the Council’s constitution. The key objective of the Council’s borrowing strategy is to secure long term funding for capital projects at borrowing rates that are as low as possible. This can result in a trade off of short term returns on deposits to obtain the best possible rate on long term borrowings.

9.2 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 during the midyear period 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, 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 the relatively recent past, the Council has not had these funds available and therefore has had to borrow.

9.3 Treasury management, and borrowing strategies in particular, continues to be influenced by the absolute level of borrowing rates and also the relationship between short and long term interest rates. Rate forecasts indicate that interest rates will remain low until 2016 which creates a "cost of carry" between what is paid on the borrowing and what is earned on the investment for any new longer term borrowing. This is because borrowing requirements are generally over a long term period of up to 50 years, while cash is currently being invested for a maximum of a year. As a result the Council will maintain an under-borrowed position throughout 2015/16. This means that the CFR will not be fully funded with loan debt during the year as cash supporting the Council's reserves, balances and cash flow will be used as a temporary measure. This strategy is prudent as it reduces the "cost of carry" while investment returns remain low, as well as reduces the Council's counterparty risk, which continues to be high and is likely to will continue throughout 2015/16.

9.4 As circumstances can change during the year, the CFO will monitor interest rates and adopt a flexible approach to any changes. The Council's borrowing strategy will also give consideration to the following when deciding to take-up new loans:

- Use internal cash balances while the current rate of interest on investments remains low and cash flow forecasts indicate that borrowing is not required;
- Consideration given to weighing the short term advantage of internal borrowing against potential long term costs if long term borrowing rates begin to increase more than forecast;
- Using PWLB, the EIB or Local Authorities for fixed term and variable rate loans;
- Maintain an appropriate debt balance between PWLB and market debt;
- Ensure new borrowings are drawn at suitable rates and periods; and
- Consider the issue of stocks and bonds if appropriate.

9.5 The Council has £40m of fixed rate Lender's Options Borrower's Option (LOBO) loans and all of them will be in their call period during 2015/16. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower (the Council) can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the Lender's discretion. As LOBOs currently make up 10.1% of the total long term external debt portfolio, this is not a significant risk. Any LOBO called will have the default position of repayment of the LOBO without penalty, i.e. the revised terms will not be accepted.

9.6 **European Investment Bank (EIB) Borrowing:**

In 2014/15 Cabinet agreed to borrow £89m from the European Investment Bank (EIB) and £4.5m from the PWLB which will be used as outlined below:

- £66.0m from the EIB to finance the Gascoigne Estate (East) Phase 1;
- £4.5m from the PWLB to fund 50% of 51 private for sale units; and
- £23.0m from the EIB to finance Abbey Road Phase 2.

The EIB borrowing will be a liability for the Council and will be include in the Council's CFR but will then be placed within a Special Purpose Vehicle (SPV), which will then be used to manage the repayment of the borrowing and interest as well as the funding of the regeneration of the Gascoigne Estate (East) Phase 1 and the Abbey Road Phase 2. The SPV will pay for these costs through the rental returns generated.

Although investment decisions will be made on behalf of the SPV, with interest returns paid to the SPV, as the risk will remain with the Council, any investment will need to be made within the parameters set within this report.

The drawdown of the full £89m was completed on 30 January 2015 at a rate of 2.207%. The £4.5m proposed to be borrowed from the PWLB will now be borrowed using internal borrowing.

To allow treasury to maintain flexibility to manage the increase in cash it is recommended that Members agree to maintain the authority delegated to the Chief Finance Officer, in consultation with the Cabinet Member for Finance, to proportionally amend the counterparty lending limits agreed within the TMSS to take into account the initial increase in cash from the EIB but also the subsequent decrease in cash balances as payments are made to the SPV. In November, Assembly agreed that this delegation should be reviewed in each treasury report and therefore it will next be considered as part of the Treasury Management Outturn report later in 2015.

9.7 **HRA Self Financing**

Central Government completed the reform of the HRA subsidy system on 28 March 2012. The Council is required to recharge interest expenditure and income attributable to the HRA in accordance with Determination issued by the CLG.

The Determinations do not set out a methodology for calculating the interest rate to use in each instance. The Council is therefore required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA Treasury Management Code of Practice recommends that authorities present this policy in the annual TMSS.

The Council has adopted a two loans pool approach for long term debt.

- The full £265.9m of PWLB long term debt from the HRA reform settlement is allocated to the HRA, with the remaining £129.0m of debt (including EIB borrowing) allocated to the GF; and

- All future long term loans are allocated into either the HRA or GF pool.

A breakdown of the HRA borrowing is provided in table 5 below:

Table 5: HRA borrowing:

Loan Type	Loan Amount	Maturity profile	Interest Rate
	£'000s	Yrs	%
PWLB	50,000	26	3.51
PWLB	50,000	36	3.52
PWLB	50,000	44	3.49
PWLB	50,000	45	3.48
PWLB	65,910	46	3.48
Total	**265,910**		

The HRA debt cap is currently set at £277.65m; however the Council has recently been given approval from the Department for Communities and Local Government, to exceed this by £3.2m in 2015/16 and by a further £10.75m in 2016/17, making the new total cap £280.85 in 2015/16 and £291.60 onwards from 2016/17.

9.8 **Repayment of Borrowing**

As short term borrowing rates are usually cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, any savings will need to be based on the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhance the balance of the portfolio (amend the maturity profile).

No loans are proposed to be repaid in 2015/16.

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.

9.9 **Policy on borrowing in advance of need**

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Given that the Council has held a significant under borrowing position over the past years, the borrowing of £89 million from the EIB has not resulted in the Council borrowing in advance of its needs.

Current forecasts indicate that it is unlikely that the Council will seek to borrow in advance in 2015/16.

10. Minimum Revenue Provision Policy Statement

10.1 In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual MRP needs to be approved before the start of the financial year.

10.2 The Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 5.

11. Member and Officer Training

11.1 The CIPFA Code requires the responsible officer, the Chief Finance Officer (CFO), to ensure that members with responsibility for treasury management receive adequate training in treasury management. Training will be arranged for Members as required. The training needs of treasury management officers are periodically reviewed.

12. Financial Implications

12.1 The financial implications are discussed in detail in this report.

13. Legal Implications

Implications completed by: Eldred Taylor-Camara, Legal Group Manager

13.1 The Local Government Act 2003 (the "Act") requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

13.2 This report sets out the Councils strategies in accordance with the Act.

14. Other Implications

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

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix 1 – Annual Investment Strategy
- Appendix 2 – Interest Rate Forecasts 2015 – 2018
- Appendix 3 – Prudential Indicators 2015/16 – 2017/18
- Appendix 4 – Minimum Revenue Provision Policy Statement
- Appendix 5 – Treasury management scheme of delegation