RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2013-2014

Item No:8

TREASURY MANAGEMENT STRATEGY INCORPORATING INVESTMENT STRATEGY, PRUDENTIAL INDICATORS and MRP STATEMENT for 2014/15

COUNCIL

26th March 2014

REPORT OF THE CORPORATE SERVICES GROUP DIRECTOR

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1.0 PURPOSE OF THE REPORT

1.1 The purpose of the report is to set out the Council's:-

- Treasury Management Strategy for 2014/15;
- Investment Strategy for 2014/15;
- Prudential and Treasury Indicators for 2013/14 (actuals to date) and 2014/15, 2015/16 and 2016/17;
- Minimum Revenue Provision (MRP) Policy Statement.

2.0 RECOMMENDATIONS

It is recommended that Members:

2.1 Approve the Treasury Management Strategy, Investment Strategy, Prudential and Treasury Indicators and the Minimum Revenue Provision (MRP) Policy Statement as set out in this report;

2.2 Grant the Section 151 Officer (or in his absence the Deputy Section 151 Officer) with delegated powers to exceed the fixed / variable limits, in the best financial interests of the Authority only, and if utilised, that this be reported to the next available meeting of Council (para 18.7 refers).

3.0 INTRODUCTION

3.1 CIPFA defines Treasury Management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.2 The Local Government Act 2003 and supporting regulations require the Council to have regard to the CIPFA Treasury Management Code of Practice and the CIPFA Prudential Code. The following report also meets the requirements of Welsh Government MRP Guidance and Welsh Government Investment Guidance.

3.3 This Treasury Management Strategy Statement details the expected activities of the Treasury Management function in the forthcoming financial year (2014/15). Its production and submission to Council is a requirement of the CIPFA Code of Practice on Treasury Management, as adopted by the Council on 6th March 2002. The 2001 Code was fully revised in 2009 with minor updates in 2011 and 2013. We continue to adopt the revised Code. Adoption of the Code is one of the Prudential Indicators. We comply in this respect.

3.4 To supplement the CIPFA Code of Practice, the Welsh Government has issued Guidance on Local Government Investments which require local authorities to report their Investment Strategy. A key requirement of the guidance is to explain management of risk associated with Treasury Management activity. Reports on actual activity will be produced after the year end and also following a mid year review. Such reports, including this strategy are subject to Member scrutiny.

3.5 The Prudential Code came into effect from 2004/05 and was fully revised during 2009 with minor updates in 2011and 2013. The Code is produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) and is underpinned by the Local Government Act 2003 and the Capital Financing regulations (Wales) 2004. The Code sets out a framework for self regulation of capital spending, in effect allowing Councils to invest in capital projects without any limit as long as they are affordable, prudent and sustainable.

3.6 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires revenue costs from capital financing decisions to be included in the budget requirement.

4.0 TREASURY MANAGEMENT STRATEGY 2014/15

4.1 The suggested Treasury Management Strategy for 2014/15 is based on officers' views on likely interest rates, supplemented with forecasts provided by the Council's independent treasury advisors. The strategy covers:

- Current Portfolio Position

- Prospects for Interest Rates
- Borrowing Strategy (including borrowing in advance of need)
- Debt Rescheduling Opportunities

4.2 Information is also provided on the use of Treasury Management advisors and the training that has taken place.

5.0 <u>Current Portfolio Position</u>

5.1 The Council's treasury portfolio position as at the end of January 2014 (Period 10) comprised:

		£M	**£M**	**Av. Rate**
<u>Debt</u>				
Fixed Rate	PWLB	109.297		4.81%
	Market	2.000		9.66%
			111.297	
Variable Rate	PWLB	0		
	Market (LOBO)	85.500		4.82%
			85.500	
			196.797	4.86%
<u>Investments</u>				
Variable Rate	Public Bodies		15.830	0.27%

5.2 A LOBO is a financial instrument called a "Lender's Option Borrower's Option". It provides a lower rate of interest for the initial period and a higher rate for the rest of its term (reversionary period), albeit that the higher rate was comparable with interest rates prevailing at the time the loans were taken. At the end of the initial period and at six monthly intervals, the lender has the option to increase the interest rate payable. This provides the Council with the option to repay the loan if the terms are not acceptable.

6.0 <u>Prospects for Interest Rates</u>

6.1 The level of the Bank Rate (set by the MPC – Monetary Policy Committee) tends to be the main factor which determines the rate of interest the Council receives on its short term investments. During 2013/14 to date, the Bank Rate has remained at 0.5%.

6.2 Estimates of average Bank Rate, as provided by our Treasury Management advisors are:

Q1 April 2014	0.50%
Q1 April 2015	0.50%
Q1 April 2016	0.75%
Q1 April 2017	1.75%

6.3 These are the basis of our projections for interest receivable. Bank Rate underpins investment returns, and whilst there is an increase in 2016/17, it is predicted to be slow and gradual. Further increases are predicted after 2016/17 to reflect the stronger outlook for growth. The Bank of England expectations are that the Bank Rate will rise toward 2% in 3 years time.

6.4 Generally, the Council borrows its long term funding from the Public Works Loans Board (PWLB). Long term PWLB rates increase and decrease in line with gilt yields (government bonds). The Council's Treasury Management advisors latest forecast of interest rates is as follows:

	5 yr	**10 yr**	**25 yr**	**50 yr**
2014/15	2.90%	3.90%	4.70%	4.80%
2015/16	3.20%	4.20%	5.00%	5.10%
2016/17	3.50%	4.50%	5.10%	5.20%

6.5 Whilst there are signs of recovery due to consumer spending and the housing market, the growth is expected to slow down as most consumers are experiencing declining disposable income, as wage increases are less than inflation.

6.6 Another key driver of the UK economy relates to the Eurozone. Growth within the Eurozone is expected to be slow for the next couple of years and is therefore likely to affect UK growth, as the EU is the UK’s biggest export market.

6.7 The Government’s austerity measures aimed at getting the public sector deficit into order are continuing, with the impact of reducing government expenditure.

6.8 Investment returns are likely to remain low during 2014/15. Borrowing rates continue to remain attractive but there will be a resultant “cost of carry” that will incur a revenue loss of the difference between the borrowing costs and investment returns.

6.9 During February 2013, one of the rating agencies, Moody’s, cut the UK’s sovereign rating of AAA to Aa1. This was due to the expectations of growth in the UK economy being sluggish over the next few years and that the agency believed the Government’s debt reduction programme faced significant challenges.

7.0 Borrowing Strategy (including borrowing in advance of need)

7.1 The Council's borrowing requirement for 2014/15 is currently £32.4m based on the current Capital Programme. The opportunities afforded by the Prudential Code increase the possibility of further borrowing being required during the year. The strategy and Prudential Limits may need to be refined accordingly in light of future decisions. Further details of Prudential Indicators and limits are in the Prudential Indicator section of this report.

7.2 Uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will continue to take a cautious approach to its treasury strategy.

7.3 The cheapest borrowing will continue to be maximising "internal borrowing", running down cash balances and foregoing interest earned at historically low rates. This also minimises counterparty risk (risk that an investment may become irrecoverable). This is our favoured approach (referred to as maintaining an "underborrowed" position). This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt.

7.4 Temporary borrowing could be taken from the money market or other public bodies such as local authorities.

7.5 Shorter term fixed rates may provide lower cost opportunities in the short/medium term. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to balancing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at low long term rates which will be higher in future years.

7.6 There are uncertainties associated with the forecasts detailed above. Alternative approaches given different interest rate forecasts are below:

- Risk of sharp fall in long and short term rates – long term borrowing will be postponed and potential rescheduling from long term to short term borrowing could be considered.
- Risk of sharper than forecast rise in long and short term rates – fixed rate borrowing taken whilst rates still cheap.

7.7 The Group Director, Corporate Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates and forecasts at the time, taking into account advice provided by our advisors and an assessment of risk. Members will be advised of borrowing activity during the year as part of the Council's quarterly performance reporting arrangements.

7.8 The revised Codes of Practice require Councils to specify their approach in terms of "Borrowing in Advance of Need". In line with the Prudential Code, Councils are able to borrow funds above its Capital Financing Requirement (ie its underlying borrowing requirement) for use in future years, thereby providing a degree of flexibility in terms of timing during the most favourable interest rate conditions. This Council's levels of debt have been and remain significantly lower than our CFR (see Prudential Code section) and it is not anticipated that borrowing in advance of need is a course of action that this Council would pursue in the short to medium term. Consequently, there is no need to set a limit in terms of value or period of time. Risks and opportunities associated with borrowing in advance of need will continue to be monitored during the year and reported in the mid year review of treasury management activities.

8.0 Debt Rescheduling Opportunities

8.1 The introduction by the PWLB in 2007 of a difference in rates applied to new borrowing and repayment of existing debt has been compounded since October 2010 by a further widening of the difference between new borrowing and repayment rates. This has meant that rescheduling is now less attractive. Consideration would have to be given to the large premiums which would be incurred on repaying debt early.

8.2 As short term borrowing rates will be considerably cheaper than long term rates, there may be potential to switch from long to short term debt. However, these savings will need to be considered in light of the premiums incurred, the short term nature of the savings, and the likely cost of refinancing those short term loans once they mature.

8.3 Early repayment of debt could also be considered. This would run down investment balances as short term rates on investments are likely to be lower than that on debt. However, premium costs may be expensive.

8.4 Any rescheduling and repayment of debt is likely to impact upon the Council's debt maturity profile and this will need to be considered in accordance with the relevant indicator.

8.5 The Council has previously taken advantage of maximising debt rescheduling opportunities. The reasons for any rescheduling to take place could include:

- the generation of savings, at minimum risk;
- to help fulfil the strategy outlined in section 7 above; or
- to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).

8.6 The Group Director, Corporate Services will monitor prevailing rates for any opportunities during the year under the close guidance of the Council's Treasury advisors.

9.0 Treasury Management Advisors

9.1 Treasury Management advisors are required to provide the Council with:

- Technical support on treasury matters, capital finance issues and suggested report formats;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice on the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies.

9.2 Whilst the advisors provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on any treasury matter remains with the Council.

9.3 Until 31st March 2014 the Treasury Management advisors are Sector Treasury Services Ltd., part of the Capita Group Plc. Treasury Management officers have recently worked with Procurement officers to award a new contract from 1st April 2014. As a result of this process, the contract has been awarded to Arlingclose Ltd.

9.4 The Council will ensure that quality of service is maintained via feedback at regular meetings with key contacts.

10.0 Member and Officer Training

10.1 During 2013/14, officers within the Treasury Management section have attended seminars facilitated by our advisors.

10.2 As part of continued professional development, officers will continue to keep up to date with emerging issues via seminars, research and regular information provided by advisors and other sources.

10.3 If any emerging issues require a specific training session to be delivered to Members, it will be facilitated.

10.4 The Councils Treasury Manager holds The Certificate in International Treasury Management – Public Finance, a professional qualification by CIPFA and the Association of Corporate Treasurers in the fundamentals of treasury management for the public service.

11.0 Reporting and Scrutiny

11.1 The Corporate Services Scrutiny Committee will continue to undertake the required scrutiny function for treasury management activities. This will include:

- Quarterly updates (as part of the Council's Performance Reporting arrangements)
- Strategy report (as reported to full Council)
- Formal mid year review of treasury management (as reported to full Council)
- Annual review (as reported to full Council).

12.0 INVESTMENT STRATEGY

12.1 The Council's investment policy has regard to the Welsh Government's Guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities will be security first, liquidity second, then return.

12.2 The key requirements of both the Code and the investment guidance (issued by the Welsh Government) are to set an investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- Specified investments the Council will use together with the minimum acceptable credit quality. These are high security (i.e. high credit quality, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.
- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.

12.3 The intention of the strategy is to provide security of investment and minimisation of risk.

12.4 Specified Investments

An investment is a Specified Investment if all of the following apply:

1. the investment is denominated in sterling
2. it is not long term

3. it is not defined as capital expenditure
4. it is of high credit quality or with one of the following public sector bodies:
    a. the UK government; or
    b. a local authority in England or Wales (as defined in S23 of the 2003 Act) or similar body in Scotland or Northern Ireland

12.5 These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

- The UK Government (such as the Debt Management Account Deposit Facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- Supranational bonds of less than one year's duration.
- A local authority, parish council or community council.
- Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This covers pooled investment vehicles, such as money market funds, rated AAA by Fitch rating agency or equivalent.
- A body that is considered of a high credit quality such as a bank or building society. This covers bodies with a minimum long term rating of A- (or the equivalent) as rated by Fitch rating agency or equivalent.
- Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies.

12.6 Credit Criteria for Specified Investments

12.7 It is at the discretion of the Local Authority to define what it considers to be a "high" credit quality. It is proposed that Members agree to limit the use of Specified Investments to those counterparties with a Short Term credit rating of at least "F1" and Long Term rating of at least "A-" (as defined by Fitch Credit Rating Agency). Equivalent ratings from other agencies are also used. Limits for each Counterparty will be set according to its credit rating. The Council uses the lowest common denominator method of selecting counterparties and applying limits. It is proposed that Members agree to set limits as follows:

Credit Criteria	**£ Limit**	**Maturity Limit**
Short Term Rating F1 or F1+ & Long Term Rating AAA	£20m	364 days
Short Term Rating F1 or F1+ & Long Term Rating AA or AA+	£15m	364 days

Short Term Rating F1 or F1+ & Long Term Rating AA-	£10m	6 mths
Short Term Rating F1 or F1+ & Long Term Rating A+,A or A-	£10m	3 mths

Investments with the Debt Management Office and other Public bodies shall have a maximum maturity of 364 days.

12.8 For Members information the scale of Short Term and Long Term Credit Ratings as defined by Fitch is as follows:

Short Term Ratings (less than 365 days)		
Decreasing strength of rating	F1+	The strongest intrinsic capacity for timely payment of financial commitments
	F1	Strong intrinsic capacity for timely payment of financial commitments
	F2	Good intrinsic capacity for timely payment of financial commitments
	F3	The intrinsic capacity for timely payment of financial commitments is adequate
	B	Minimal capacity for timely payment of financial commitments, plus heightened vulnerability to near term adverse changes in financial and economic conditions.
	C	Default is a real possibility
	D	Actual or imminent payment default

Long Term (Issuer Default) Ratings (greater than 364 days)		
Decreasing strength of rating	AAA	Investment Grade – Highest Credit Quality
	AA	Investment Grade – Very High Credit Quality
	A	Investment Grade – High Credit Quality
	BBB	Investment Grade – Good Credit Quality
	BB	Speculative Grade – Possibility of Credit Risk developing
	B	Highly Speculative Grade – Significant Credit Present
	CCC CC C	High Default Risk

12.9 In addition to Short Term and Long Term ratings, institutions are assigned viability and support ratings. “Viability ratings” attempt to assess a bank’s capacity to meet its obligations (excluding support from outside the entity). “AAA” is the strongest rating and “F” is the weakest. “Support ratings” provide a judgement of a supporter’s ability to support a counterparty should it run into difficulties with “1” being the strongest and “5” being the weakest.

12.10 In addition to the Long Term and Short Term credit rating criteria set above, it is recommended that Members agree that the Council should only invest in counterparties with either at least “AA” for viability ratings (*very high fundamental credit quality and considered highly unlikely that the bank would have to rely on extraordinary support to avoid default*) **or** at least a support rating of “1” *(A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question.).*

12.11 The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council’s criteria, the other does not, the institution will fall outside the lending criteria.

12.12 A Counterparty List will be maintained in accordance with the limits as defined above with one further over-riding principle. At the point of an investment being made with a counterparty, it will not exceed the higher of:

- o 10% of the Council’s overall investment portfolio at the time of making the investment (accepting that during the course of the investment period it may exceed this as cash balances fluctuate); or
- o £2m

This limit shall not apply to the Debt Management Office (where all deposits are guaranteed by HM Government and therefore have the equivalent of the UK sovereign credit rating) nor AAA rated money market funds (which by their nature have in-built diversification), nor public bodies.

12.13 Although many of the banks on the Counterparty List originate from outside of the UK, the Council will only place deposits into their UK accounts.

12.14 The Council's Treasury Management advisors inform us immediately of any individual rating changes, and the counterparty list is updated accordingly. Any counterparty failing to meet the criteria, or those on a negative creditwatch (at risk of downgrade) will be removed from the list immediately. An exception to this might be where the UK sovereign rating is on negative watch resulting in a wholesale application of negative watch to all UK counterparties. It must be noted that on occasion, ratings may be downgraded when an investment has already been made. New counterparties will be added to the list if they meet the defined criteria during the year.

12.15 In addition, limits will be applied to country, group and sector. These limits are applied to the portfolio at the time of investment.

- o The minimum credit rating of a bank's sovereign will be AA- (this is for non UK sovereign).
- o No more than 60% will be placed with any non UK country at any time
- o No more than the lower of 10% of total portfolio and £10m will be placed with a single group company
- o Sector limits are as follows:
  - o Banks 70%
  - o Building Societies 30%
  - o Money Market Funds 90%
  - o Debt Management Office 100%
  - o Other Public Bodies 100%

Included within the above will be the part nationalised UK banks, Lloyds Bank and Royal Bank of Scotland. These can be used if they meet the required criteria.

12.16 The revised Code of Practice now requires Councils to not rely solely on credit ratings but to supplement it with other information. The other information referred to includes quality financial press, credit default swaps, share prices, annual reports, statements to markets, information on government support for banks, credit ratings of that government support, rates being paid, what other banks are saying, information provided by advisors, market price (and movement of market price) of existing debt securities issued by counterparties. This represents a significant pool of "other information".

12.17 The review of all such information will be incorporated into the Councils decision making processes although it will not be a simplistic and quick process and will need to be considered alongside the relative benefits of making one investment over another (eg versus DMO) and the relative risks of exposing the Council's resources.

12.18 Members will also recall that all of the Councils investments were transferred to the Debt Management Office DMADF (Debt Management Account Deposit Facility) upon the onset of the unprecedented national and international economic crisis. Whilst there is a cost of this security in terms of a loss of interest (now reduced to approximately 0.23% being the difference between Bank Rate and our average interest rate received), this (along with other Government backed public sector bodies) is considered to be the safest course of action at this current time. These arrangements will be kept under constant review, especially given the financial impact on the General Fund through lost interest. This is estimated to be approximately £6.1k for every three months invested (based on average cash holdings equating to £9M).

12.19 With regards to the Council's £3M investment with the Icelandic institution, Heritable Bank, the administrators have stated that it is unlikely that creditors will receive any further material dividend. The Council has received repayments (dividends) which amount in total to £2.829M.

12.20 Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

Investment	**£ Limit**	**Maturity Limit**
Deposits with Banks / Building Societies as per the Counterparty List > 365 days Minimum long term rating Fitch AA or equivalent Short term Fitch F1 or equivalent	£10m	3 years
Callable Deposit with Banks / Building Societies as per the Counterparty List > 365 days Minimum long term rating Fitch AA or equivalent Short term Fitch F1 or equivalent	£10m	3 years
Gilt Edged Securities (Value of principal may fluctuate) (These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. The value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.)	£10m	3 years
Supranational Bonds greater than 1 year to maturity. (Value of principal may fluctuate) to have UK government sovereign rating (The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.)	£10m	3 years
Banks whose ratings fall below the specified investment criteria if all three criteria below are met: o Wholesale deposits in the bank are covered by a government guarantee o The government providing guarantee is rated AAA by all three rating agencies o The Council's investments with the bank are limited to amounts and maturities within the terms of the guarantee.	£5m	1 Month

The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£5m	Overnight

12.21 Investments in "Non Specified Investments" **<u>in total</u>** should be no greater than £15m. In addition, as per Specified Investments, at the time of making the investment, it should not be greater than the higher of 10% of the total portfolio or £2m.

12.22 Local Authority Mortgage Scheme

12.23 As approved by Council on 4th July 2012, during September 2012, the Council launched the Local Authority Mortgage Scheme which supports First Time Buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years.

12.24 This is not strictly an Investment – its primary purpose is to support first time buyers, stimulate the housing market and any beneficial wider economic regeneration which goes with it. The deposit is classed as a service investment rather than a treasury management investment and is therefore outside of the Specified / Non Specified categories.

12.25 Notwithstanding this, it is a deviation from the Council's normal treasury management operations. It will require a deposit to be placed with one or more institutions for a fixed period of 5 years. Clearly this exposes the Council to an element of Counterparty risk which is monitored by officers.

13.0 Risk Benchmarking

13.1 In accordance with the WAG guidance (revised 2009), this Investment Strategy sets out the Council's policies for giving priority to firstly, the security of investments, secondly liquidity, and thirdly yield. It sets out the Council's criteria for choosing investment counterparties and limiting the exposure of risk of loss.

13.2 The revised codes and statutory guidance require the consideration, approval and monitoring of security and liquidity benchmarks. Yield benchmarks are currently widely used and less subjective than those relating to security and liquidity.

13.3 The benchmarks for security, liquidity and yield are targets, not limits and as such, may be breached from time to time. The purpose of the benchmark is to monitor trends and act as early warning signals. Actual activity levels will be reported in the mid year and annual reports.

13.4 Security

13.5 Security had previously been evidenced solely by the application of minimum credit criteria to investment counterparties, through credit ratings supplied by one of the three rating agencies, Fitch, Moody's and/or Standard & Poor's. The revised Codes and regulations require the extension of security monitoring by applying historic default trends to our own investment portfolio.

13.6 The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is 0.00% historic risk of default when compared to the whole portfolio. This reaffirms the fact that the Council places security above yield.

13.7 Liquidity

13.8 This is defined as having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities. The Council maintains a bank overdraft facility of £5m.

13.9 It is recommended that the Council sets limits for

- Liquid short term deposits available with a week's notice.
- Weighted Average Life benchmark and maximum. The shorter the weighted average life of the portfolio implies less risk.

As we are maintaining low levels of cash to minimise credit risk, the setting of such targets / limits is not appropriate.

13.10 Any investment for greater than 365 days will be made with a prudent approach to cashflow requirements and in accordance with above limits.

13.11 The minimum amount to be held during 2014/15 in investments less than 365 days is the lower of

- £20m; or,
- the total value of the Council's investment portfolio.

13.12 Yield

13.13 The benchmark used is 7 day LIBID. At the moment, as our operating strategy is to only invest in the Debt Management Office or other public bodies, it is unlikely we will meet this target.

14.0 Forecast for Investment Returns

14.1 Traditionally, investments which would have been invested longer would secure better returns, however uncertainty over counterparty creditworthiness suggests short dated investments in higher credit quality establishments will provide better security. The Council will continue to favour security above return.

14.2 Expectations on shorter-term interest rates, on which investment decisions are based, show the current 0.5% Bank Rate not rising until 2016. Our projected interest receipts will be prudent, reflecting our low risk strategy

15.0 PRUDENTIAL CODE LIMITS FOR 2014/15

15.1 There is a statutory duty under the Local Government Act 2003 for the Council to determine and keep under review how much it can afford to borrow. The Council must have due regard to the **Prudential Code** when setting it's affordable borrowing limit ("Authorised Limit"). This requires the Council to ensure that total capital investment and borrowing remains affordable, sustainable and prudent.

15.2 To comply with both the Prudential Code and Treasury Management Code, the Council has to determine and set Prudential Indicators in relation to capital expenditure, external debt and treasury management activities. The purpose of the indicators is to provide a framework for Capital Expenditure decision making.

15.3 To comply with the Codes every Council is required to agree a set of Prudential indicators prior to the start of the financial year. These indicators must be prepared by the Chief Finance Officer and presented to Council, as part of the budget setting process. The indicators cover a three year period and must be monitored during the year.

15.4 The indicators are purely for internal use by the Council and are not intended for use as comparators (i.e. between Councils) nor should they be viewed individually. The real value will arise as a result of monitoring the movement in indicators over time.

15.5 Capital Expenditure is predominantly funded by Welsh Government support, capital grants and capital receipts. The remaining balance of expenditure will form a borrowing need. General capital funding from the Welsh Government takes the form of "supported borrowing". Any amounts of capital expenditure above these limits will be classed as unsupported and will have an impact on the Council Tax (unless extra borrowing costs are funded through existing budgets).

15.6 The following indicators are required (by the Prudential Code) to be approved:

- o Capital Expenditure
- o Capital Financing Requirement
- o External Debt (Gross)
- o Authorised Limit
- o Operational Boundary
- o Ratio of Financing Costs to Net Revenue Stream
- o Incremental Impact of capital investment decisions on Band D Council Tax

15.7 The following indicators are required (by the Treasury Management Code) to be approved:

- o Adoption of the CIPFA Code of Practice on Treasury Management
- o Interest Rate Exposure
- o Debt Maturity Profile
- o Funds invested for more than one year

16.0 <u>Capital Expenditure and the Capital Financing Requirement</u>

16.1 The Capital Expenditure plans of the Council will be financed through various sources such as capital receipts, grants, other contributions. The remaining element which cannot be immediately financed from resources will constitute our borrowing requirement. The estimated level of available capital resources is provided in summary as the Capital Expenditure Indicators below***.***

Indicator : Capital Expenditure

	2013/14 Projected Outturn £M	2014/15 Estimate £M	2015/16 Estimate £M	2016/17 Estimate £M
Supported spend	57.400	46.051	21.220	18.418
Unsupported spend	29.836	25.402	2.043	0.000
Total spend	87.236	71.453	23.263	18.418
Financed by:-				
Borrowing	36.870	32.361	9.002	6.959
Other Capital Resources (e.g. Grants, Capital Receipts)	50.366	39.092	14.261	11.459

16.2 The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for capital purposes. The CFR is capital expenditure that has not yet been paid for from either revenue or capital resources.

16.3 The expected movement in the CFR over the next three years is dependent on the level of supported and unsupported capital expenditure and decisions taken during the budgeting cycle.

16.4 The unsupported element of borrowing relates to the capital expenditure freedom allowed under the Prudential Code. The Prudential Code anticipates that these freedoms would enable Councils to enter into projects such as "spend to save" schemes or decisions to allocate additional resource from revenue to capital, to enable service enhancements. Members have already shown their willingness to use this option for schemes such as improvements in highways infrastructure and investment in schools.

16.5 The main factor limiting the Council's ability to undertake unsupported capital expenditure is whether the revenue resource is available to support in full the implications of capital expenditure, i.e. both borrowing costs and running costs. In other words, can the Council afford the implications of the unsupported capital expenditure?

16.6 The Council's expectations for the CFR in the next three years is shown below.

Indicator : Capital Financing Requirement (CFR)

	2013/14 31/03/14 Projected Outturn £M	2014/15 31/03/15 Estimate £M	2015/16 31/03/16 Estimate £M	2016/17 31/03/17 Estimate £M
CFR	378.324	395.533	389.627	381.324
Net movement in CFR		17.209	(5.906)	(8.303)

16.7 A key risk is that the level of Welsh Government support has been estimated and is, therefore, subject to change. Similarly, some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over this time. Officers will continue to monitor the totality of capital resources and will report back to Members if further action is required.

16.8 As a result of the accounting changes in the Code of Practice on Local Authority Accounting 2009, the Private Finance Initiative (PFI) scheme at Garth Olwg is presented on the Council's balance sheet as a Fixed Asset. As a result our CFR includes payments falling due for the school and lifelong learning centre. Similarly, Finance Lease arrangements are also included in the calculation.

16.9 The expected external debt for each year is as detailed below.

Indicator : External Debt

	2013/14 31/03/14 Projected Outturn £M	2014/15 31/03/15 Estimate £M	2015/16 31/03/16 Estimate £M	2016/17 31/03/17 Estimate £M
Borrowing	201.305	255.521	287.378	315.692
Other long term liabilities	27.571	26.421	25.225	23.982
Total External Debt 31st March	228.876	281.942	312.603	339.674
Net movement in External Debt		53.066	30.661	27.071

16.10 Long Term Liabilities include the Council's obligation under the PFI scheme and future finance lease payments.

17.0 Limits to Borrowing Activity

17.1 The first key control over the Council's activity is to ensure that, over the medium term, borrowing will only be for a capital purpose. The Council needs to ensure that external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimate of the additional capital financing requirement for the next three financial years. This allows some flexibility within a three-year period to deliver an effective treasury management strategy.

Borrowing Activity (Gross Borrowing)

	2013/14 31/03/14 Projected Outturn £M	2014/15 31/03/15 Estimate £M	2015/16 31/03/16 Estimate £M	2016/17 31/03/17 Estimate £M
Gross Borrowing	228.876	281.942	312.603	339.674
Capital Financing Requirement	378.324	395.533	389.627	381.324

17.2 As the above shows, gross borrowing is below the relevant CFR for current, and future years. This is termed "underborrowing". This view takes into account current commitments, existing plans, and the proposals in the budget report. Again, this indicator will be monitored and revised at Council, if necessary, during the three-year period.

17.3 The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be set, monitored and revised by Members. It reflects the maximum level of borrowing to fund existing capital commitments, which could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some added headroom for unexpected movements.

17.4 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Council's plans, or those of a specific Council. The government has not yet exercised this control.

Indicator : The Authorised Limit

	2013/14 31/03/14 Projected Outturn £M	2014/15 31/03/15 Estimate £M	2015/16 31/03/16 Estimate £M	2016/17 31/03/17 Estimate £M
Gross Borrowing Limit	201.305	352.000	353.000	354.000
Other long term liabilities	27.571	28.000	27.000	26.000
Authorised Limit	228.876	380.000	380.000	380.000

17.5 The Operational Boundary is based on the probable external debt during the course of the year; actual borrowing could vary around this boundary, for short times, during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Indicator : The Operational Boundary

	2013/14 31/03/14 Projected Outturn £M	2014/15 31/03/15 Estimate £M	2015/16 31/03/16 Estimate £M	2016/17 31/03/17 Estimate £M
Gross Borrowing Limit	201.305	252.000	283.000	314.000
Other long term liabilities	27.571	28.000	27.000	26.000
Operational Boundary	228.876	280.000	310.000	340.000

18.0 Affordability Prudential Indicators

18.1 Previous sections have covered overall capital and control of borrowing indicators, but there is also a requirement to assess the affordability of capital investment plans. This provides an indication of the impact of the capital investment plans on the overall Council finances.

18.2 The Ratio of Financing Costs to Net Revenue Stream identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the "net revenue stream". The net revenue stream for the General Fund is the amount collectable from Council Tax payers added to the Council's Rate Support Grant (RSG) and Non Domestic Rates (NDR). The key use of this indicator is to compare trends in the ratio of financing costs to the net revenue stream, over time.

Indicator : Ratio of Financing Costs to Net Revenue Stream

	2013/14 Comparator	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
General Fund	5.28%	5.36%	5.46%	5.68%

18.3 The Incremental Impact Indicator identifies the revenue costs associated with proposed changes to the three year capital programme compared to the Council's existing commitments and current plans.

18.4 Capital Investment by its very nature has a knock-on effect into the General Fund Revenue Account. For example, capital investment in our infrastructure assets should result in a reduced revenue maintenance burden etc.

18.5 What is also evident is the impact upon services of this investment, including the provision of doorstep recycling to all properties, improved leisure facilities, and enhanced street care services.

Indicator : Incremental impact of capital investment decisions on the Band D Council Tax

	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Annual Impact on Council Tax - Band D	£0.46	-£0.14	-£0.33
Annual Impact on Council Tax - Band A	£0.30	-£0.09	-£0.22
Percentage Impact on Council Tax Band D	0.04%	-0.01%	-0.02%

18.6 The first Treasury Management indicator is that the Council has adopted the CIPFA Treasury Management Code of Practice. This Council adopted the Code during March 2002. The Code has been fully revised in 2009 with minor changes in 2011. We continue to adopt the revised version.

18.7 The Code requires limits to be set for :

I. Upper limits on variable rate exposure – this indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

II. Upper limits on fixed rate exposure – similar to the above indicator this covers a maximum limit on fixed interest rates.

Indicator : Interest Rate Exposure

	2013/14 Projected Outturn	2013/14	2014/15	2015/16	2016/17
Borrowing					
Limits on fixed rates	62%	55%-90%	55%-90%	55%-90%	55%-90%
Limits on variable rates	38%	10%-45%	10%-45%	10%-45%	10%-45%
Investments					
Limits on fixed rates	0%	0%-25%	0%-25%	0%-25%	0%-25%
Limits on variable rates	100%	75%-100%	75%-100%	75%-100%	75%-100%
Net Borrowing					
Limits on fixed rates	63%	55%-125%	55%-125%	55%-125%	55%-125%
Limits on variable rates	37%	-25%-45%	-25%-45%	-25%-45%	-25%-45%

18.8 For monitoring interest rate exposure purposes, LOBO's are included as variable rate debt. Although not a requirement of the Prudential Code, an internal limit of LOBO debt is set as follows:

	£M	% of Debt Portfolio
LOBO limits	100	45

The amount of LOBO debt held in 2013/14 is £85.5m being 37% of our total debt portfolio. This internally set limit may be temporarily exceeded as a consequence of debt restructuring activities.

18.9 The maturity structure indicator sets gross limits to reduce the Council's exposure to large fixed rate sums falling due for refinancing annually.

The 2011 CIPFA Treasury Management Code has revised the maturity structure indicator guidance. As a result, LOBO loans are deemed to have a maturity date of the next call date.

Indicator : Maturity Structure

	2013/14 Projected Outturn	Upper Limit	Lower Limit
Under 12 months	37%	60%	0%
12 months to 2 years	2%	60%	0%
2 years to 5 years	1%	60%	0%
5 years to 10 years	0%	70%	0%
10 years to 20 years	13%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	35%	90%	0%
40 years to 50 years	12%	90%	0%

18.10 In order to maximise investment returns there may be opportunities for sums to be invested for longer than one year. This would only be undertaken with a prudent view of the primary considerations of security and liquidity.

18.11 The following indicator takes account of projected resources available for investment and cashflow forecasts.

Indicator : Total principal funds invested for periods longer than 364 days

Maximum principal sums invested over 1 year	£15M

18.12 During 2013/14, there have been no investments with a maturity of greater than 1 year, with the exception of the LAMS investment, refer to para. 12.22, which is deemed a service investment as opposed to a treasury investment. Given the circumstances and objectives outlined in the Investment Strategy, it is unlikely the Council will invest for periods greater than one year.

19.0 THE MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

19.1 In accordance with legislative requirements applicable to local government (Local Government Act 2003), there is a requirement to charge an amount to revenue each year in respect of capital expenditure. This charge is known as the "Minimum Revenue Provision (MRP)”.

19.2 The implementation of the Prudential Code in 2004 (and subsequent updates) provided greater flexibilities for Councils to borrow to fund capital projects over and above their previous level of capital approvals - referred to as prudential or unsupported borrowing.

19.3 To complement the flexibilities afforded by the Prudential Code, the Welsh Government introduced new regulations (Local Authorities (Capital Finance and Accounting)(Wales)(Amendment) Regulations 2008 [S.I. 2008/588(W.59)]) during March 2008 which provide a number of differing options for charging to revenue costs incurred in respect of Capital Expenditure. The regulations also required the approval by full Council of this MRP Statement.

19.4 Supported Borrowing - The ability to charge at 4% of Capital Financing Requirement remains for supported borrowing, but with the removal of a technical adjusting figure (known as the "A" adjustment). This amendment has been applied within the Council's accounts since 2007/08 and it is proposed that this policy be continued for all new supported borrowing. Regulations also allow for the commencement of MRP to be in line with the asset being brought into use.

19.5 Unsupported Borrowing - The historic 4% MRP has been removed as an option for unsupported (Prudential) borrowing and replaced with 3 alternatives :

- Charge in equal instalments (or to match the benefits derived) over the life of the asset created (asset life must be applied for any expenditure capitalised under a Capitalisation Direction);
- Annuity method; or
- Charge in accordance with the depreciation of the asset.

19.6 It is my view that each of these methods might be appropriate depending on the type of asset being created / funded by prudential borrowing. It is also feasible that an alternative method might be appropriate (for example, linked to a payback period) - this is also recognised in the guidance. Accordingly, I am of the view that a decision upon the relevant method to apply should be made as part of the option appraisal decision to proceed with any prudential borrowing on a project by project basis.

19.7 PFI and Finance lease schemes - MRP is equivalent to the principal value of repayments as permitted by regulations.

20.0 CONCLUSIONS

20.1 This report provides the Council's Treasury Management Strategy and Annual Investment Strategy for 2014/15, and details the Prudential Indicators for the 3 year period 2014/15 to 2016/17. It also includes the Council's policy statement on the Minimum Revenue Provision (MRP).

20.2 With regards to the Treasury Management Strategy, a cautious approach will continue to be followed. The Section 151 Officer will monitor the interest rate environment and adopt a pragmatic approach to any changing circumstances, in consultation with the Council's independent treasury advisors.

20.3 With regards to the Prudential Indicators, these will be monitored throughout the financial year with details reported to Members as part of the Council's quarterly performance reporting framework and scrutiny process.