## SECTION 4 - TREASURY MANAGMENT STRATEGY, INVESTMENT STRATEGY, PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY

### 35. PURPOSE

35.1 In 2009 the Chartered Institute of Public Finance and Accountancy (CIPFA) amended its Treasury Management Code of Practice. The council is required to comply with all aspects of the CIPFA Code. Hounslow adopted the revised Code at the council meeting on 2 March 2010. There were some further minor amendments to the Code in November 2011, primarily to reflect the changes arising from Housing Revenue Account (HRA) reform, which have been accepted by Borough Council.

35.2 The Local Government Act 2003 and subsequent supporting regulations require the council to set out a suite of reports covering its treasury management activities. This is a composite report and includes the:

- Annual Treasury Management Strategy for borrowing
- Annual Investment Strategy for managing our investments and for giving priority to the security and liquidity of those investments
- Minimum Revenue Provision Statement setting out what provision is made in the General Fund for the repayment of debt and how this provision has been calculated
- Prudential and Treasury Indicators to ensure that the council's investment plans are affordable, prudent and sustainable.

35.3 The five key objectives of the strategies are to ensure:

- An efficiently structured debt portfolio to minimise costs
- The security and liquidity of our investments
- Investment returns are maximised whilst protecting the security of investments
- Effective cash flow management
- The management of risks.

### 36. TREASURY MANAGEMENT ANNUAL STRAEGY 2014/15

36.1 The strategy for 2014/15 is based upon the Assistant Director Strategic Finance's views on interest rates, as informed by leading market forecasts provided by the council's external treasury advisor. The strategy covers:

- The current treasury position – base portfolio position
- Prospects for interest rates
- The borrowing requirement and strategy for the General Fund
- The borrowing requirement and strategy for the Housing Revenue Account
- Policy on borrowing in advance of need
- Debt rescheduling and repayment
- The Annual Investment Strategy
- The Minimum Revenue Provision (MRP) Strategy
- Money laundering
- Policy on use of external service providers
- Training

- Risk
- Highways Maintenance PFI (Private Finance Initiative) – Treasury Risk
- Treasury Limits and Prudential Indicators
- Financial implications.

36.2 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 a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that any increases in capital expenditure must be limited to a level where increases in charges to revenue are kept to a level that is affordable within the projected income of the council for the foreseeable future. Such charges to revenue arise from increases in debt charges caused by increased borrowing to finance additional capital expenditure, and from any increases in running costs from new capital projects.

**37. BASE PORTFOLIO POSITION**

37.1 The council's treasury portfolio position at 31 March 2013 was as follows:

| | | Total principal £m | HRA £m | GF £m | Average rate % |
|---|---|---|---|---|---|
| **Fixed rate funding** | PWLB | 180.3 | 165.2 | 15.1 | |
| | Market | 72.0 | 66.0 | 6.0 | |
| **Total borrowing** | | **252.3** | **231.2** | **21.1** | 5.64 |
| Total investments | | **(191.0)** | **(27.4)** | **(163.6)** | 1.18 |
| Net borrowing/investments | | **61.3** | **203.8** | **(142.5)** | |

HRA – Housing Revenue Account
GF – General Fund
PWLB - Public Works Loan Board

37.2 As reported in last year's Treasury Management Strategy, the council's borrowings were split into two portfolios as at 1 April 2012, following the move to self-financing of the Housing Revenue Account (HRA). This split was made on the basis of the Capital Financing Requirement (CFR) at 1 April 2012. [Hence the HRA has £231m of external loans, whereas the General Fund only has £21m.]

37.3 All of the authority's external borrowing is fixed rate, and hence will not be directly affected by rising interest rates. The council would benefit from rising interest rates on its temporary investments. The monies available for investing are primarily cash flow derived, and are only available temporarily pending expenditure.

**38. PROSPECTS FOR INTEREST RATES**

38.1 The council has appointed Capita Asset Services as its treasury advisor. Part of their role is to assist the council to formulate a view on interest rates.

**39. ECONOMIC BACKGROUND**

39.1 The Bank of England has left the bank rate unchanged at the historic low of 0.50% since March 2009. The current economic outlook has several key treasury management implications:

- although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away. There are still major concerns as to how these will be managed over the next few years as levels of government debt to GDP ratios, in some countries, continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods

- investment returns are likely to remain relatively low during 2014/15 and beyond
- borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which could occur, where new borrowing is necessary to finance new capital expenditure and/or to refinance maturing debt
- there will remain a "cost of carry" to any new borrowing which causes an increase in short term investments as this would currently incur a revenue loss between borrowing costs and investment returns.

## 40. INTEREST RATE FORECAST

40.1 The following table gives the Capita view on interest rates:

| (%) | Mar 14 | Jun 14 | Sep 14 | Dec 14 | Mar 15 | Sep 15 | Dec 15 | Mar 16 | Jun 16 |
|---|---|---|---|---|---|---|---|---|---|
| **Bank rate** | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 |
| **5yr PWLB rate** | 2.50 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.10 | 3.20 |
| **50yr PWLB rate** | 4.40 | 4.50 | 4.50 | 4.60 | 4.70 | 4.90 | 5.00 | 5.10 | 5.20 |

## 41. BANK RATE

41.1 The bank rate has stayed at 0.50% since March 2009. The bank rate is not expected to start increasing until June 2016, when it is projected to rise to 0.75%.

## 42. LONG TERM PUBLIC WORKS LOAD BOARD (PWLB) RATE

42.1 The 5-year PWLB rate is expected to rise from 2.50% to reach 3.00% in 2015, and 3.20% in June 2016. The 50-year PWLB rate is forecast to rise from 4.40% to reach 5.00% in 2015, and 5.2% in June 2016.

42.2 From the above it can be seen that the yield curve is positive, with longer-term rates being higher than short-term rates.

42.3 The PWLB introduced a new 'certainty' rate from 1 November 2012 for authorities that submitted a return of their borrowing requirements for the next three years. The 'certainty' rate is discounted at 0.20% below the published standard borrowing rates. The London Borough of Hounslow submitted an accepted return, and would therefore be able to borrow at 0.20% below the rates in the table at paragraph 40.1, if external borrowing need was to be identified. The 'project rate' identified by the Chancellor in the 2012 Autumn Statement is 0.40% below standard rates, but only applies to 'local enterprise partnerships'.

## 43. CAPITAL FINANCING STRATEGY

43.1 The current prudential system of capital controls allows local authorities to determine their own levels of capital investment, as long as that level of investment is affordable, prudent and sustainable. The Capital Programme has been set at a level that can be financed within identified resources. The Capital Programme's main source of financing is capital grants, primarily from the Government. Capital receipts from the disposal of properties are also used. Other sources of finance are direct revenue financing and borrowing. The borrowing arrangements to finance the Capital Programme are included in this Treasury Management Strategy.

## 44. GENERAL FUND BORROWING REQUIREMENT

44.1 The council's General Fund borrowing requirement, as identified at 30 November 2013, is as follows:

| | 2013/14 £m | 2014/15 £m | 2015/16 £m | 2016/17 £m |
|---|---|---|---|---|
| New supported borrowing | 3.3 | 4.8 | 0 | 0 |
| New prudential borrowing | 2.3 | 0.1 | 0 | 0 |
| Replacement borrowing | 0.8 | 3.0 | 1.0 | 0.1 |
| **Total borrowing requirement** | **6.4** | **7.9** | **1.0** | **0.1** |

44.2 Supported borrowing relates to allocations by the Government where the financing costs are provided for within the revenue Formula Grant system. There is no supported borrowing after 2010/11 and what would have been included in the grant settlement is allocated via capital grant. Supported borrowing from 2013/14 to 2014/15 relates to schemes on which approval had already been received. These are all education schemes. The prudential borrowing refers to borrowing where costs fall on the council's revenue budget and do not attract government support. For 2013/14 and 2014/15 the General Fund prudential borrowing relates to borrowing for the finalisation of the Leisure Refurbishment Programme. The revenue implications of borrowing have been included in the council's General Fund budget. Replacement borrowing relates to borrowing for maturing debt.

44.3 The above table only includes borrowing for schemes that have already been approved. There is potential new borrowing from 2014/15 to 2016/17 to finance the schools funding gap and any move from the Civic Centre.

## 45. GENEREAL FUND BORROWING STRATEGY

45.1 As detailed in paragraph 44.1 the General Fund borrowing requirement for 2014/15 is estimated to be £7.9m and £1.0m for 2015/16. This is a combination of borrowing to finance capital expenditure and replacement borrowing for maturing debts. The requirement takes account of the two main objectives of the Prudential Code, which are that:

a) capital expenditure plans are affordable, and
b) all external borrowing and other long-term liabilities are within prudent and sustainable limits.

45.2 The borrowing requirement for 2014/15, of £7.9m, is expected to be met by using internal resources and reducing investments.

45.3 Any potential new expenditure for the schools funding gap and the Civic Centre move is not likely to impact until late 2014/15. However, if economically advantageous these schemes could be financed from external borrowing.

## 46. HOUSING REVENUE ACCOUNT BORROWING REQUIREMENT

46.1 The council's Housing Revenue Account borrowing requirement, as identified at 30 November 2013, is as follows:

| | 2013/14 £m | 2014/15 £m | 2015/16 £m | 2016/17 £m |
|---|---|---|---|---|
| New borrowing | 0 | 0 | 0 | 0 |
| Replacement borrowing | 9.5 | 32.3 | 11.3 | 0.4 |
| **Total borrowing requirement** | **9.5** | **32.3** | **11.3** | **0.4** |

46.2 New borrowing to finance capital expenditure is determined by the HRA Business Plan. There is no approved timetabled new borrowing at present, but this could change if a decision is taken to use the borrowing headroom allowed within the plan. However, there is a large borrowing requirement to replace maturing debt over the next couple of years.

## 47. HOUSING REVENUE ACCOUNT BORROWING STRATEGY

47.1 The borrowing requirement for 2014/15, of £32.3m, is expected to be met temporarily by the General Fund lending resources to the HRA, at PWLB rates.

## 48. POLICY ON BORROWING IN ADVANCE OF NEED

48.1 The borrowing requirement for 2014/15 for the General Fund and the HRA is expected to be met by using internal resources and reducing external investments. For 2015/16 the majority of the borrowing need relates to the HRA. Consideration will be given to refinancing maturing debt in 2014/15/16 ahead of need if interest rates are advantageous to secure long term value for money.

48.2 It is not permissible to borrow in advance of need simply to reinvest in the money markets.

## 49. DEBT REPAYMENT AND RESCHEDULING

49.1 The potential for making savings by using investment balances for repaying debt prematurely will be kept under review. However, under the current interest rate structure the premiums that would be incurred by prematurely repaying debt make this action uneconomic.

## 50. ANNUAL INVESTMENT STRATEGY

50.1 Appendix E details the approach for identifying counterparties deemed sufficiently secure to place our investments. The monies the council has available for investing are primarily cash flow derived, and are only available temporarily pending expenditure. Hence, they will primarily be invested in periods of less than one year and for no longer than two years. Our investment priorities are security and liquidity. This council will only invest in institutions with the highest security. The policy on counterparties is regularly reviewed.

50.2 Funds will primarily be invested according to the Secretary of State's definition of specified investments, these being sterling deposits made for periods of less than one year, offering high security and high liquidity. Specified investments include deposits with the UK government, other local authorities, money market funds, and institutions with high credit ratings. A lending list is compiled to include counter parties satisfying the criteria set by the authority. The Annual Investment Strategy is attached at Appendix E to this report.

## 51. THE MINIMUM REVENUE PROVISION (MRP) STRATEGY

51.1 It is a statutory duty to set aside from revenue, for the General Fund only, a Minimum Revenue Provision (MRP) to repay the principal of debt. The council is required to approve a specific statement on this, which is Appendix F of this report. The purpose of the Statement is to ensure that provision is prudent, allowing debt to be repaid over a period commensurate with that over which the capital expenditure will provide benefits. Decisions on how and whether to repay housing debt will be dependent on the HRA Business Plan. Currently, maturing housing debt is being refinanced.

## 52. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

52.1 The council uses Capita Asset Services (formerly Sector) as its external treasury management adviser. The council recognises that responsibility for treasury management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon its external service provider.

52.2 The council also recognises that there is value in employing external providers of treasury management services in order to have access to specialist skills and resources. A competitive tendering exercise was carried out earlier this year, and as a result of that process Capita Asset Services was reappointed for a period of three years from 1 July 2013 with the option to extend for a further year.

52.3 Council officers meet with Capita quarterly and provide them with a monthly list of outstanding investments. Capita also has details of the council's debt portfolio, so they are able to monitor against current interest rates and give timely advice.

## 53. TRAINING

53.1 In line with best practice, the council operates a programme of treasury management training. There is a strong commitment that all staff dealing with treasury management receive comprehensive training on an ongoing basis. It is also a requirement of the CIPFA Code that members receive appropriate training. Since May 2010 two training sessions to members have been delivered to which all members were invited. Chief Officers have also been trained and a training log is maintained.

## 54. RISK

54.1 The key risks associated with treasury management issues are:

- **Interest rate risk**: the council's long term borrowing is all fixed rate debt and so will not be directly affected by increases in interest rates. Overall the council will benefit from rises in interest rates during 2014/15 as its short-term investments are affected by increases in interest rates;
- **Counter party risks**: the Investment Strategy details how we identify counter-parties for investing with. We use only the highest credit rated institutions and set limits for exposure to each organisation;
- **Liquidity risk**: this is the risk that cash will not be available when required. This risk is reduced by the preparation of cash forecasts, and investing bearing in mind future cash requirements. The majority of our investments are less than one year and all less than two years. There is currently no reason to change this policy;
- **Maturity risk**: our long term borrowing is phased over the next 60 years, so in any one year we will not be faced with a significant amount of debt needing to be refinanced.

## 55. HIGHWAYS MAINTENANCE PFI (PRIVATE FINANCE INITIATIVE) – TREASURY RISK

55.1 The council has started a 25 year contract with Vinci Ringway to deliver highways related services from January 2013. The financial model is dependent on interest being generated on cash flows over the life of the contract. It is anticipated that the required interest will be generated using our current counter parties i.e. additional risk will not need to be taken to generate the interest.

## 56. TREASURY LIMITS AND PRUDENTIAL INDICATORS

56.1 It is a statutory duty under Section 3 of the Local Government Act 2003 for the council to 'determine and keep under review' how much it can afford to borrow. This is called the "Affordable Borrowing Limit" and is the authorised limit for external debt referred to in the CIPFA Prudential Code. It is the maximum amount of loan debt that may be outstanding at any point in time, and includes both borrowing for capital purposes and an allowance for any temporary borrowing. The Prudential Code requires the council to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and rent levels is 'acceptable'. All of the limits are contained in full in the section on the Prudential Code in Appendix G to this report.

## 57. FINANCIAL IMPLICATIONS

57.1 External borrowing using PWLB and market loans are projected as below. At the moment this table assumes HRA maturing debt will be financed by a loan from the General Fund

57.2 External borrowing (i.e. PWLB and market loans)

| | March 2013 Actual £m | March 2014 Estimate £m | March 2015 Estimate £m |
|---|---|---|---|
| General Fund | 21.1 | 20.2 | 17.2 |
| HRA | 231.2 | 221.7 | 189.4 |
| Total | **252.3** | **241.9** | **206.6** |

57.3 The revenue implications of the treasury management policy for 2013/14 and 2014/15 are as below. Provision has been made within the appropriate budgets for these costs.

| | Original 2013/14 £000 | Revised 2013/14 £000 | Estimate 2014/15 £000 |
|---|---|---|---|
| General Fund (GF) | | | |
| MRP – principal repayment | 5,467 | 5,433 | 5,359 |
| Interest payable on borrowing | 1,151 | 1,151 | 909 |
| Interest receivable on investments | (1,478) | (2,178) | (1,125) |
| Premium re debt rescheduling | 101 | 97 | 97 |
| **Total GF** | **5,241** | **4,503** | **5,240** |
| Housing Revenue Account (HRA) | | | |
| MRP – principal repayment | 0 | 0 | 0 |
| Interest payable on borrowing | 13,086 | 13,090 | 11,165 |
| Interest receivable on investments | (291) | (283) | (274) |
| Premium re debt rescheduling | 7 | 7 | 7 |
| **Total HRA** | **12,802** | **12,814** | **10,898** |

57.4 The interest payable is reducing for both the General Fund and the Housing Revenue Account. This is due to the maturing of high interest debt of over 9% of £10m in

2013/14 and £35m in 2014/15. It is particularly significant for the Housing Revenue Account, where there is an annual revenue saving of £1.9m. The maturing HRA debt is being refinanced by a loan from the General Fund at PWLB rates. The saving for the General Fund is £0.2m, since the latter does not have significant amounts of external debt.

57.5 Budgeted interest receivable for the General Fund has increased from £1.5m to £2.2m within 2013/14 due to a combination of placing deposits at higher rates of interest than budgeted for (primarily with RBS) and due to higher temporary cash flows than originally forecast. This has been reported to Members as part of the regular quarterly monitoring reports and is beneficial to the budget.

57.6 However, in 2014/15 investment income is forecast to drop back to £1.1m. This is due to lower rates of interest being anticipated for our temporary investments. In particular we have some beneficial two year investments maturing in the summer of 2014. We are also forecasting a lower level of cash balances, as balances are used. For example, £60m of capital grants is budgeted to be applied to the Schools Building Programme.