



AGENDA ITEM: 20

Council: 24th February 2016

Report of: Interim Borough Treasurer

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SUBJECT: CAPITAL FINANCING AND TREASURY MANAGEMENT FRAMEWORK

Wards affected: Borough Wide

1.0 PURPOSE OF REPORT

1.1 To set the framework for capital financing and treasury management operations for the next financial year.

2.0 RECOMMENDATIONS

2.1 That the projected position in respect of the Prudential Indicators, as set out in Appendix 1, for 2015-16 be noted.

2.2 That the Prudential Indicators for the next three years be agreed, as set out in Appendix 2.

2.3 That the minimum revenue provision (MRP) policy as set out in Appendix 3, be approved for the next financial year.

2.4 That the Treasury Management Strategy as set out in section 8.0, be approved.

3.0 BACKGROUND

3.1 The introduction of the 2003 Prudential Code for Capital Finance allowed Councils to determine their own level of borrowing taking account of a set of prudential indicators. The general maxim is that borrowing is to be affordable, prudent and by conclusion sustainable. Subsequent to that legislation, the 2012 Housing Self Financing regulations introduced a debt cap that set a maximum amount for Housing Revenue Account borrowing.

3.2 These indicators are to be used as a guide in order to determine an affordable level of borrowing that the Council can undertake in order to support its capital programme. Further, the indicators are to be calculated over a three-year period

in order to highlight any trends. Also, indicators have to be calculated for the General Revenue Account (GRA) and the Housing Revenue Account (HRA) in certain instances.

- 3.3 The Council approved Prudential Indicators for 2015-16 and the subsequent two financial years in February 2015. It is recognised best practice that Treasury Management arrangements and the MRP policy should be considered on a regular basis to ensure they take account of recent developments and new information. These areas have been reviewed and a number of changes are proposed as a result.
- 3.4 The CIPFA Treasury Management Code of Practice requires Authorities to have a Treasury Management Strategy and this report sets out the Council's strategy for the next financial year.

4.0 FORECAST PRUDENTIAL INDICATOR PERFORMANCE

- 4.1 Appendix 1, Part A, details the estimate and the projected outturn in relation to the principle of affordability contained within The Prudential Code for the current year.
- 4.2 The first indicator shows that there is a small financing cost on the GRA as the forecast income earned is less than any interest paid, including any provision made in respect of MRP. This is due to the fact that investment income returns have been relatively low in recent years, in line with base interest rates.
- 4.3 With regard to the HRA, there is a fixed interest charge of £3.056m levied on this account as a result of the borrowing of £88.212m undertaken for HRA self financing. Consequently the ratio of net financing costs to net revenue stream is higher than for the GRA.
- 4.4 The second indicator, impact of capital decisions on the Council Tax, is nil. This is because the Council has not borrowed to fund its general capital programme and consequently does not have borrowing interest costs. The capital programme does include a scheme for the development of commercial units, referred to as the Green Shoots project, as well as investment in Solar PV. However, as the business cases for these schemes demonstrate that they should produce a surplus then this would not adversely affect the Council Tax requirement.
- 4.5 Appendix 1, Part A, Table 2 details the Prudential Indicator in relation to capital expenditure, which falls under the principle of Prudence. The figures represent the total scheme approvals for the capital programme. The main message is that the schemes are fully financed and that the actual expenditure incurred to date is less than the budgetary sums provided.
- 4.6 There is also a requirement to report upon the Capital Financing Requirement of the Council. This indicator details the authority's underlying need to borrow for a capital purpose. Due to its nature it can only be reported upon when the fixed asset accounts are closed. Hence, this will be reported to Members in Summer 2016.

- 4.7 Appendix 1, Part B, shows that the Council has not breached any of its borrowing limits during the financial year. The figure for 'Other Long Term Liabilities' represents the agreement the Council has with Serco Paisa in respect of the investment they are undertaking within the Council's leisure centres.
- 4.8 Overall, the indicators show that even though the Council's financial landscape is challenging it is currently in a healthy financial position and that there are no significant problems that need to be brought to the attention of Members.

5.0 THREE-YEAR PRUDENTIAL INDICATORS

- 5.1 Appendix 2, Part A, details the Prudential Indicators in relation to affordability for the next three years
- 5.2 With regard to the GRA there are net financing costs in 2016-17 as investment income earned is expected to continue to be relatively low. The HRA's position is largely determined by the debt costs associated with the self financing payment.
- 5.3 The incremental impact on the Council Tax as a result of the capital programme is estimated to be nil as although there may be some borrowing in the future, for example invest to save schemes, these would be progressed only if the business case demonstrated that they had at least a neutral effect on the revenue position. The Government have introduced a policy whereby HRA rental levels have to be reduced by 1% per annum over the next four years, and consequently the HRA capital programme will not have a direct effect on the rental levels that are charged.
- 5.4 Appendix 2, Table 5, details the Indicators with regard to future capital expenditure and the capital financing requirement. The Council's three year capital programme is discussed elsewhere on the agenda, as such, the figures presented are in line with those previously reported to Members, and will be updated to reflect the decisions made at this Council meeting.
- 5.5 The capital financing requirement measures the Council's underlying need to borrow for a capital purpose. As a key indicator of prudence the Prudential Code states:
- 'In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current year and next two financial years.'
- 5.6 The Council should have no difficulty meeting this requirement in 2015-16 nor are any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in this budget report.
- 5.7 Appendix 2, Part B, details the prudential indicators that are relevant for the purposes of setting an integrated treasury management strategy.
- 5.8 In respect of external debt, it is recommended that the Council approve the authorised limits, in Appendix 2, for its total external debt gross of investments.

These authorised limits are consistent with the authority's current commitments, existing plans and the proposals in the budget reports for capital expenditure and financing. They are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

- 5.9 The Council is also asked to approve the operational boundary for external debt for the same period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included in the authorised limit. Within the authorised limit and operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Borough Treasurer has authority to affect movement between these figures for borrowing and other long-term liabilities within the total authorised and operational boundary for any individual year. Any such changes will be reported to the Council at its next meeting following the change.

6.0 MRP AND HOUSING DEBT REPAYMENT POLICIES

- 6.1 The basic idea behind the MRP is that a minimum level of funding should be set aside each year for the repayment of borrowing or other long term liabilities on a prudent basis. There are regulatory requirements that must be met in setting the MRP and the policy should be reviewed on an annual basis. The proposed policy for the next year is set out in Appendix 3.
- 6.2 The HRA Debt Repayment policy needs to be reviewed in the context of the change that the Government has made in terms of requiring rent levels to be reduced by 1% per year over the next 4 years, and consequently this matter has been dealt with in the Housing Account Budget report elsewhere on this agenda.

7.0 CIPFA TREASURY MANAGEMENT CODE OF PRACTICE

- 7.1 The Council has adopted the CIPFA Treasury Management Code of Practice in order to govern its Treasury Management operations. The last major update by CIPFA was in 2009 and the Authority formally adopted this updated policy at Council in July 2010. A further minor review of the policy was carried out in January 2014 and was presented to Council in February 2014. The Council Officers that carry out Treasury Management operations are suitably qualified and experienced and work within the framework set out by the Code of Practice.

8.0 TREASURY MANAGEMENT STRATEGY 2016-17

- 8.1 The Council's cash flow position is actively managed in order to avoid any short-term deficits arising. Consequently, it is not expected that any short-term borrowing will be required during 2016-17.

PROSPECTS FOR INTEREST RATES

- 8.2 Capita Treasury Services act as a Treasury Adviser to the Council and part of their service is to assist in formulating views on interest rates. The table below gives the Capita central view on future interest rate levels:

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Base Rate	0.50%	0.50%	0.50%	0.75%	0.75%

Public Works Loan Board (PWLB) interest rate on 25 year borrowing 3.27%

- 8.3 As can be seen from the above table, base rate forecasts are still very subdued at the present time. Capita is currently predicting that the base rate will remain steady at 0.5% until towards the end of the 2016/17 financial year, but increased economic uncertainty may push out the first increase in the rate until after this period. PWLB rates are expected to rise very slowly over the same period.
- 8.4 The Treasury Management team will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions to the Council at the next available opportunity.

INVESTMENTS STRATEGY

- 8.5 The key feature of the Investment Strategy will remain, as it has been in the past, the security of the money that is invested, followed by liquidity and finally, yield. It is anticipated that, during 2016/17, the Council should on average have somewhere in the region of £20m available for investment. This estimation is predicated on the position that cash flow has reduced as a result of increased housing capital spending in conjunction with funding reductions from central government in 2015/16 and 2016/17.
- 8.6 There are a number of protocols in place to guarantee the safety of our investments. We will continue with these protocols, in that we will only invest with Local Authorities or U.K. based counterparties that have the best available credit rating. Currently four British High Street banks and four Building Societies meet the criteria.
- 8.7 There will be regular interaction with Capita to ensure that we keep ourselves up to date with changes in the markets and the financial situation in general. The Council will look to ensure the security and liquidity of its funds invested and then look to maximise its return on investments. Performance will continue to be monitored against our previously declared benchmark of the 3 month LIBID interest rate.

BORROWING STRATEGY

- 8.8 The debt for the Housing self-financing payment of £88.212m to the Government was arranged via the Public Works Loan Board, as it offered the best available rates at that time. The structure of this debt has been set over the longer term, with loan periods ranging from 15 to a maximum of 50 years. The structure of the debt is in line with treasury risk management principles and has also taken

account of the HRA debt repayment policy. A detailed outline of the debt profile is attached in Appendix 2.

- 8.9 Whilst the payment to government is set, the HRA may also undertake future borrowing up to the limit of the debt cap set by the Government. This debt cap includes an additional £2.5m approved by the Government in 2015-16 for new house building as part of the Firbeck Revival project. In the first instance any funding requirement for increased housing investment will be met by reducing the level of external investments as their interest rates are significantly lower than external borrowing. However as the level of investment increases in the housing stock there will come a point where external borrowing will be required.
- 8.10 The Council has also approved borrowing to fund the Greenshoots project and investment in Solar PV. Once again any funding required for this investment will initially be met from internal borrowing (by reducing the level of external investments) rather than by borrowing externally due to current interest rate differentials.

9.0 SUSTAINABILITY IMPLICATIONS / COMMUNITY STRATEGY

- 9.1 The Capital Financing and Treasury Management Framework ensures that robust financial decisions are made. The strategies in place provide for sound financial management decision making with regards to the Council's assets and their sustainability.

10.0 RISK ASSESSMENT

- 10.1 The Council is signed up to the CIPFA Treasury Management Code of Practice and it reviews the Prudential Indicators on a regular basis. It is, therefore, minimising the risks associated with financing decisions.

Background Documents

Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes 2011 Edition.

Equality Impact Assessment

The decision does not have any direct impact on members of the public, employees, elected members and/or stakeholders. Therefore, no Equality impact assessment is required.

Appendices

Appendix 1 – Forecast Indicators

Appendix 2 – Three year prudential indicators

Appendix 3 – Minimum Revenue Provision