Audit Committee **Date:** 21st April 2015

TREASURY MANAGEMENT STRATEGY 2015/16

Further information on the subject of this report can be obtained from
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Swindon Borough Council

Appendix 1- Treasury Management Strategy 2015/16

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Appendix 1- Treasury Management Strategy 2015/16

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1 Current Portfolio Position

1.1 The capital expenditure plans set in Annex 1 to Appendix 1 summarises the Councils current and future plans. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

1.2 The Council's actual treasury portfolio position at 31 March 2013, with forward projections are summarised below. The table shows the actual external borrowing (both relating to the general fund and the HRA), against the borrowing requirement (shown through the Capital Financing Requirement or "CFR"), highlighting any over or under borrowing. The CFR represents the amount of borrowing required to fund capital expenditure, but not yet taken out.

Table 1 - Portfolio position forecasts				
	14/15	**15/16**	**16/17**	**17/18**
	£'000's	£'000's	£'000's	£'000's
Gross Borrowing b/fwd	266,564	255,058	268,557	312,056
New Borroiwng	-	20,000	50,000	60,000
Maturing Debt	- 11,506	- 6,501	- 6,501	- 1,501
Gross Borrowing c/fwd	**255,058**	**268,557**	**312,056**	**370,555**
Net Investments c/fwd	- 70,000	- 75,000	- 80,000	- 80,000
Net Borrowing c/fwd	**185,058**	**193,557**	**232,056**	**290,555**
CFR	476,696	475,510	484,259	502,722
Less PFI liabilities	- 55,541	- 54,156	- 52,810	- 51,280
Net Borrowing Requirement	**421,155**	**421,354**	**431,449**	**451,442**
(Under)/Over borrowing	**- 236,097**	**- 227,797**	**- 199,393**	**- 160,887**

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2 Prospects for Interest Rates and Economic Outlook

2.1 The Council has appointed Capita Asset Services (formerly Sector Group) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Capita central view.

Table 2 – Prospects for Interest Rates

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2014	0.50	2.50	3.90	3.90
Mar 2015	0.50	2.70	4.00	4.00
Jun 2015	0.75	2.70	4.10	4.10
Sep 2015	0.75	2.80	4.30	4.30
Dec 2015	1.00	2.90	4.40	4.40
Mar 2016	1.00	3.00	4.50	4.50
Jun 2016	1.25	3.10	4.60	4.60
Sep 2016	1.25	3.20	4.70	4.70
Dec 2016	1.50	3.30	4.70	4.70
Mar 2017	1.50	3.40	4.80	4.80
Jun 2017	1.75	3.50	4.80	4.80
Sep 2017	2.00	3.50	4.90	4.90
Dec 2017	2.25	3.50	4.90	4.90
Mar 2018	2.50	3.50	5.00	5.00

2.2 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 and especially during 2014, to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2015, particularly in the services and construction sectors. However, growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone.

2.3 There does need to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this initial stage in the recovery to become more firmly established. One drag on the economy is that wage inflation has been lower than CPI inflation so eroding disposable income and living standards, although income tax cuts have mitigated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by warranting increases in

pay rates. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen in the near future.The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

2.4 Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. During July to October 2014, a building accumulation of negative news has led to an overall trend of falling rates. 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 higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

2.5 There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3 Minimum Revenue Provision Policy Statement

3.1 The Council is required to charge an element of the accumulated General Fund capital spend each year (measured through the CFR) to revenue (the minimum revenue provision or ”MRP”), although it is also allowed to undertake additional voluntary payments if required.

3.2 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to Councils, as long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

“For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP will be based on the CFR. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year. From 1 April 2008 for all unsupported borrowing the MRP will be based on the estimated life of the assets, in accordance with the regulations.

MRP in relation to capital expenditure funded through borrowing incurred on the Wichelstowe project, will be deferred and the liability repaid through future capital receipts from the site. Should there be a shortfall between the debt and eventual receipts, the balance will incur an annual MRP charge.

This methodology will also be applied to other capital expenditure funded from borrowing where there is an intention to repay the borrowing from future receipts and where there is a strong likelihood that this will happen"

3.3 No revenue charge is currently required for the HRA. However under HRA reform the HRA will be required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact on the HRA revenue budget, regulations will allow the Major Repairs Allowance (MRA) to be used as a proxy for depreciation for the first five years, which will neutralise any revenue impact. MRA will continue be applied as a proxy for depreciation in 2013/14.

4 Borrowing Strategy

4.1 The Council is currently maintaining an under-borrowed position. This means that the there is a shortfall between the amount of long-term loans required to fund capital expenditure funded through borrowing (known as the Capital Financing Requirement or "CFR"), and the actual level of external taken out. The difference is known as "Internal Borrowing" and represents the temporary funding of capital expenditure from the Council's reserves, balances and working capital due to it currently being a cheaper option while investment rates are low.

4.2 While the council will maintain an under borrowed position on the General Fund (the HRA is fully borrowed up to the CFR), the Council will at some point need borrow to fund its current Capital Programme as the level of available cash balances reduces. Whilst taking long-term external borrowing will obviously increase the Councils debt charges, the benefit is in the medium to longer term as rates are currently still low historically.

4.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Board Director Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the

anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years

Borrowing in Advance of Need

4.4 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 Capital Financing Requirement 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.

Loan Re-scheduling

4.5 As As short term borrowing rates will be considerably 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, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

4.6 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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

4.7 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

4.8 All rescheduling will be reported to the Cabinet at the earliest meeting following its action

5 Investment Policy, Creditworthiness Policy and Investment Strategy

Introduction: changes to credit rating methodology

5.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may

commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

5.2 It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

5.3 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

5.4 Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

5.5 As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. "Rating Watch" and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS ("Credit Default Swap") prices as an overlay to ratings in our new methodology.

Investment Policy

5.6 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, followed by return on investment.

5.7 In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for 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 Capita ratings service, banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

5.8 Further, the Council's officers recognise 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 and in relation to the economic and political environments in which institutions operate. The assessment will also take 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" (similar to insurance policies around debt default) and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors.

5.9 Other information sources used will include the financial press, share price 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. 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 minimisation of risk. Investment instruments identified for use in the financial year are listed in Annex 2 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices & Schedules.

Creditworthiness Policy

5.10 This Council applies the creditworthiness service provided by Capita Asset Services. This service employs sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with additional data to provide a weighted scoring system 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 duration for investments.

5.11 Our creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

5.12 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- Banks - good credit quality - the Council will only use banks within the parameters of the creditworthiness service provided by Capita
- The Council's own banker for transactional purposes if the bank falls below the above criteria.
- Building societies - The Council will use all societies which meet the ratings for banks outlined above;
- Money Market Funds - The council will use AAA rated Money Markey Funds
- UK Government
- Local authorities, parish councils etc.
- Supranational institutions (See Annex 2 for Details)

Investment Strategy

5.13 **In-house funds**. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

5.14 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise around June 2016. Bank Rate forecasts for financial year ends (March) are:

- 2015/16 1.00%
- 2016/17 1.50%
- 2017/18 2.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

- 2015/16 0.90%
- 2016/17 1.50%
- 2017/18 2.00%

Investment Periods

Investment periods are currently restricted to no longer than 12 months, which was primarily introduced in order to limit exposure to market risk, particular in the light of bank failures. These risks have reduced substantially over the past 12 months and therefore the strategy for 15/16 is to increase the maximum lending period to 24

months in order to attract better returns at no additional risk. Lending to counterparties will still be in line with the creditworthiness policy detailed above and recommended by Capita and it is proposed to limit these to a total of £20m. Any investments to banks and building societies for a period in excess of 365 days would be classed as a "non-specified investment" as detailed in Annex 2 to this strategy.

6 Policy on the use of external service providers

6.1 The Council uses Capita Asset Services as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services 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 properly agreed and documented, and subjected to regular review.

Annexes

- Annex 1 - Prudential Indicators.
- Annex 2 - Credit and Counterparty Risk Management, Specified and Non- Specified Investments

Key Decision / Decision in Forward Plan

This is not a key decision for the Cabinet (as the approval of the full Council is required) and is included in the Cabinet Forward Plan