DECISION

RIBBLE VALLEY BOROUGH COUNCIL
REPORT TO POLICY & FINANCE COMMITTEE

Agenda Item No 16

meeting date: 27 MARCH 2012
title: TREASURY MANAGEMENT STRATEGY
submitted by: DIRECTOR OF RESOURCES
principal author: TRUDY HOLDERNESS

1 PURPOSE

1.1 To seek member approval for the Council's Treasury Management Strategy for the 2012/13 financial year.

2 BACKGROUND

2.1 The Prudential Code for Capital Finance in Local Authorities (the Code) initially came into effect from 1 April 2004. It was fully revised in 2009 to incorporate changes as a result of the move to International Financial Reporting Standard (IFRS) and has since been updated following regulatory changes resulting from the Localism Bill (2011).

2.2 The prudential code requires authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits and by publishing actuals, for a range of prudential indicators. It also requires them to ensure their treasury management practices are in accordance with good practice.

2.3 The importance of treasury management has increased as a result of the freedoms provided by this Prudential Code. It covers the borrowing and investment activities and the effective management of associated risks. Its activities are strictly regulated by statutory requirements and a professional code of practice (CIPFA Code of Practice on Treasury Management).

2.4 A revised Treasury Management Code of Practice was published in November 2009 following the House of Commons Select Committee and Audit Commissions investigations into the collapse of the Icelandic banks.

2.5 Key changes included enhanced scrutiny roles for those charged with governance, more transparent reporting requirements and greater emphasis on the requirements for ensuring those charged with governance have sufficient skills to adequately perform their role.

2.6 Theses key changes are included in the following requirements:

- Minimum reporting requirement – the council should receive at least three reports during the year:
  - One prior to the start of the financial year which sets out the strategy on the proposed treasury management activities for the year and a review of the organisations approved treasury management policy statement and practices
  - A mid-year review; and
  - One after the close of the financial year reporting operational activity.
- Scrutiny – the Authorities strategy should identify the body responsible for the scrutiny of treasury management.

- Training for those charged with governance – The Director of Resources must ensure that appropriate training is available in order for those responsible for treasury management to effectively discharge their duties. This includes those charged with governance and officers.
- Approval – Full Council should approve the treasury management strategy. This committee approves the strategy, which is then formally approved by Full Council.

3 THE TREASURY MANAGEMENT STRATEGY

3.1 The treasury management code requires the council to produce a treasury management strategy and prudential indicators on an annual basis. The strategy covers the operation of the treasury function and its likely activities for the forthcoming year, including a number of prudential indicators. The treasury management strategy also includes the Annual Investment Strategy, which is a requirement of the Department for Communities and Local Government (DCLG) Investment Guidance.

3.2 A key requirement of the strategy is to explain both the risks and the management of the risks associated with the treasury service.

3.3 The attached strategy at Annex 1 covers:

- The current treasury position
- A review of the prospects for interest rates
- The Council's borrowing and debt strategy
- The Council's investment strategy
- Capital programme financing strategy
- Limits on treasury management activities and prudential indicators
- Current debt portfolio position
- Annual investment strategy

3.4 Recent months have seen repeated turmoil in the financial markets due to concerns in the Eurozone. Both Moody's and Fitch have downgraded the credit ratings of a number of UK banks and building societies over the past few months. These downgrades are a consequence of the Government's policy to reduce the likelihood that they would be bailed out in a crisis i.e. they should be viewed as a transfer of risk from taxpayers to the bank's creditors.

3.5 Previously we always worked on the belief that if a major British bank or building society got into financial trouble the Government of the day would rescue them because to not do so would have considerable ramifications across financial markets. However, given the tremendous uncertainty in the money markets at the current time we can no longer be assured this would be the case.

3.6 This uncertainty reinforces this Council's policy of first and foremost securing the safety of principal amounts invested, with rate of return a secondary consideration. This is achieved by investing only with high rating institutions, particularly the Debt Management Office (DMO). Any investments with the DMO are guaranteed by HM Government. Although rates are somewhat lower than the prevailing market rates, these investments offer the least risk and as such the rate reflects the security of the investment.

3 RECOMMENDED THAT COMMITTEE

3.1 Recommend to Council the Treasury Management Strategy as set out in Annex 1.

SENIOR ACCOUNTANT

PF23-12/LO/AC
19 March 2012

MARCH 2012

RIBBLE VALLEY

BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY 2012/13

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Introduction

The Council is required to adopt the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (Fully revised second edition 2009, reviewed 2011) and it is a requirement under that Code of Practice to produce an annual strategy report on proposed treasury management activities for the year.

The purpose of the Treasury Strategy is to establish the framework for the effective and efficient management of the Council's treasury management activity, within legislative, regulatory, and best practice regimes, and balancing risk against reward in the best interests of stewardship of the public purse.

Key Principles
The key principles of the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes are that:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Setting the Treasury Management Strategy for 2012/13

In setting the Treasury Management Strategy, the Council must have regard for the following factors:

- The current treasury position and debt portfolio position
- The prospects for interest rates
- The approved Capital Programme
- Limits on treasury management activities and prudential indicators

The Current Treasury Position and Debt Portfolio Position

The Public Works Loans Board debt is the largest proportion of the Council's borrowing debt, and is gradually decreasing as payments of the principle are made year by year. It estimated that the outstanding principle on all PWLB loans at 31 March 2012 will be £436K. The bond will remain unchanged until it is repaid and relates to the Sidney Whiteside Charity.

Investments at the end of the 2011/12 financial year are anticipated to be £700K based on current cash flow forecasts. These investments relate to monies placed with institution on our counterparty list.

There was no short term borrowing required at the 31 March 2011, and none is forecast for the 31 March 2012. Only very occasionally has the Council utilised short term borrowing in order to temporarily aid cash flow.

A summary of the Council's treasury position at the end of the previous financial year (2010/11) and that anticipated at the end of 2011/12 is summarised below.

	31 March 2011 Actual £	Actual Average Rate %	31 March 2012 Estimate £	Estimated Average Rate %
Borrowing				
Fixed Rate Debt-PWLB	507,024	4.9	435,916	4.9
Other Debt – Bond	7,500	0.6	7,500	0.6
Total Debt	**514,524**		**443,416**	
Investments				
Short Term Investments	-280,000	0.6	-700,000	0.3
Total Investments	**-280,000**		**-700,000**	

The Council's current treasury position is not at risk from movements in interest rates as all current PWLB borrowing is on fixed rate. Should the council choose to take any future borrowing on variable rates this would expose the council to a greater risk from any adverse movement in interest rates.

The forecast balance of PWLB debt shown above for the 31 March 2012 will comprise the individual loans as shown in the table below:

Original loan Amount £	Term	Interest Rate	Estimated Principal Outstanding at 31 March 2012 £	Year of Final Repayment
250,000	7 years	4.50% Fixed	89,286	2014/15
250,000	10 years	4.60% Fixed	137,500	2017/18
250,000	15 years	4.75% Fixed	4,130	2022/23
250,000	25 years	4.88% Fixed	205,000	2032/33
		Total PWLB	**435,916**	

The total debt, comprising both PWLB and the bond, is summarised in the table below, showing the estimated debt maturity assuming no further borrowing is undertaken.

ESTIMATED DEBT MATURITY ANALYSIS AS AT 31 MARCH 2012		
Maturity	**£'000**	**%**
Under 12 Months	71	16.04
12 Months and Within 24 Months	71	16.04
24 Months and Within 5 Years	124	27.97
5 Years and Within 10 Years	64	14.54
10 Years and Above	113	25.41
Total PWLB and Bond	**443**	**100.00**

Prospects for Interest Rates

The Monetary Policy Committee (MPC) of the bank of England takes interest rate decisions. It is the banks core purpose to maintain the integrity and value of the currency. It pursues this core purpose primarily through the conduct of monetary policy and by setting short term interest rates the bank aims to meet the Government inflation targets.

The government has set the bank's MPC a target for annual inflation rate of the consumer price index (CPI) of 2%.

The MPC can do little to alter the near term path of inflation. Its task is to set policy so that the inflation outlook is close to its target.

The economy was particularly weak in 2011 (Q4), with GDP provisionally estimated to have contracted by 0.2%. Some business survey indicators pointed to a pickup in output at the beginning of 2012 however the quarterly path of output is likely to be volatile through 2012.

GDP growth is likely to remain weak in the near term, before gradually strengthening as household real income recover supported by continued stimulus from monetary policy. The weak external environment, tight credit conditions and continuing fiscal consolidation are all likely to act as brakes on growth. The most significant threat to the domestic recovery stems from developments in the euro area, where there remain concerns about the indebtedness and competitiveness of some member countries.

CPI inflation fell to 4.2% in December, down from 5.2% in September but still above the 2% target. The sharp decline in inflation was largely accounted for by falling contributions from food and petrol prices. But the effects of the past increase in VAT and in the prices of energy and other imported goods and services continue to keep twelve month inflation well above the target.

The MPC forecast is for inflation to continue to decline during 2012 to below the 2% target by the beginning of next year. This partly reflects a further diminution in the upward pressure from past rises in energy and import prices. It also rests on a reduction in domestically generated inflation, as slack in the labour market continues to restrain wage growth, and productivity growth picks up. Further ahead, inflation is projected to rise slowly towards the target, as the margin of economic slack diminishes, and businesses continue to restore profit margins that were squeezed during and after the recession. However there are substantial uncertainties around this likely path of inflation.

At its February meeting, the MPC noted that GDP was likely to remain weak in the near term and to strengthen gradually thereafter. Without further monetary stimulus it was more likely than not that inflation would be below the 2% target in the medium term. The Committee therefore judged it appropriate to increase the size of the asset purchase programme by £50 billion to £325 billion, while maintaining bank rate at 0.5%, in order to meet the 2% CPI inflation target over the medium term. Those assets purchases increase the amount of money in the economy.

The CPI inflation projections in the MPC February inflation report based on the interest rate at 0.50% and £325 billion asset purchases were as follows:

	Annual Inflation %
2012 Q1	3.35
2012 Q2	2.97
2012 Q3	2.53
2012 Q4	1.87
2013 Q1	1.61
2013 Q2	1.65
2013 Q3	1.69
2013 Q4	1.77
2014 Q1	1.78

In the period leading up to the MPC's February decision on bank rate, the path implied by forward market interest rates was for Bank Rate to remain at 0.5% until 2013 Q3 and to rise gradually thereafter. The path at the time of the February Bank of England inflation report was, on average, 0.2 percentage points lower than that assumed in the November report. The February projection assumed a total stock of asset purchases of £325 billion compared to £275 billion in the November Projections.

The expected movement in interest rates is shown below:

	Base Rates %	
	November 2011	February 2012
2012 Q1	0.50	0.50
2012 Q2	0.50	0.50
2012 Q3	0.50	0.50
2012 Q4	0.50	0.50
2013 Q1	0.60	0.50
2013 Q2	0.60	0.50
2013 Q3	0.70	0.50
2013 Q4	0.80	0.60
2014 Q1	0.90	0.60
2014 Q2	1.00	0.70
2014 Q3	1.10	0.80
2014 Q4	1.20	0.90
2015 Q1		1.00

Public Works Loan Board interest rates show a similar pattern in the near term.

	Fixed Rate %
1 –2 years	1.32
5 - 6 Years	1.59
20 – 25 Years	3.38

Projection is therefore that interest rates will remain below 1% for the next financial year.

The Approved Capital Programme

The Council has approved a capital programme for the period 2012/13 to 2014/15. Particularly due to the limited resources that the council had available, the capital programme was restricted to the absolute basic requirements to keep the Council's services running over the coming three years.

The use of borrowing to support the capital programme has been kept to an average of £100,000 per annum in line with recommendations from the council's Budget Working Group and as approved by Policy and Finance Committee. This will be met from internal borrowing and it is not forecast that there will be a need for any increase in external borrowing to support the currently approved capital programme.

A summary of the approved capital programme and its financing are provided in the table below

	2012/13 £	2013/14 £	2014/15 £
Estimated Brought forward from previous year	**-731,015**	**-300,635**	**-312,635**
Unsupported Borrowing	-134,860	-86,000	-86,000
Usable Capital Receipts	-25,000	-25,000	-25,000
Disabled Facilities Grants	-109,000	-109,000	-109,000
New Homes Bonus	-107,240	0	0
VAT Shelter	-132,340	0	-163,000
Estimated Total Available Resources	**-1,239,455**	**-520,635**	**-695,635**
Less Total of Approved Capital Schemes	938,820	208,000	395,000
Estimated Resources to carry forward	**-300,635**	**-312,635**	**-300,635**

Limits on Treasury Management Activities and Prudential Indicators

The Local Government Act 2003 required the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

A key indicator of prudence is to ensure that over the medium term net borrowing will only be for a capital purpose and that net external borrowing does not except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirements for the current and the next two financial years.

The council has agreed a capital programme for the period 2012/13 to 2014/15 financial years, which is the remaining term of the current council. The prudential indicators are prepared based on the approved capital programme. The capital financing requirement for the authority for the current and future years is:

Capital Financing Requirement				
31/03/11 Actual	**31/03/12 Revised Estimate**	**31/03/13 Estimate**	**31/03/14 Estimate**	**31/03/15 Estimate**
£'000	**£'000**	**£'000**	**£'000**	**£'000**
4,041	3,989	3,976	3,914	3,852

The authorised limit for our total external debt, gross of investments for the next three financial years is detailed in the table below.

Authorised Limit for External Debt			
	2012/13 £'000	**2013/14 £'000**	**2014/15 £'000**
Borrowing	14,420	14,132	14,242
Other Long-Term Liabilities	0	0	0
Total	**14,420**	**14,132**	**14,242**

These limits have been estimated taking into account the authorities current commitments, existing plans and proposals for capital expenditure and financing with sufficient headroom to allow for operational management, for example unusual cash movements.

In addition to the authorised limits for external debt an operational boundary for external debt was approved as part of the annual budget. The proposed operational boundary is based on the same estimates as the authorised limits but without the additional headroom. The operational boundary for our external debt for the next three years is shown in the table below.

Operational Boundary for External Debt			
	2012/13 £'000	**2013/14 £'000**	**2014/15 £'000**
Borrowing	5,900	5,547	5,639
Other Long Term Liabilities	0	0	0
Total	**5,900**	**5,547**	**5,639**

The aim of the prudential indicators is to contain the activity of the treasury function within certain limits thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions that could impact negatively on the Council's overall financial position.

The introduction of the prudential code saw the replacement of limits previously imposed with four new prudential indicators.

- Upper limits on variable rate exposure. This indicator identifies a maximum limit for variable interest rates based upon the debt provision net of investments.
- Upper limits on fixed rate exposure. Similar to the previous indicators, this covers a maximum limit on fixed interest rates
- Total principal funds invested for a period longer than 364 days. These limits are set to reduce the need for early sale of an investment and are based on the availability of investments after each year-end.
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

LIMITS ON INTEREST RATE EXPOSURE			
	2012/13 £000	**2013/14 £000**	**2014/15 £000**
Maximum Principal Sums Borrowed >364 days	5,900	5,547	5,639
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	20%	20%	20%

MATURITY STRUCTURE OF BORROWING		
	Upper Limit %	**Lower Limit %**
Under 12 Months	20	0
12 Months and Within 24 Months	20	0
24 Months and Within 5 Years	40	0
5 Years and Within 10 Years	30	0
10 Years and Above	90	0

Borrowing and Debt Strategy 2012/13 – 2014/15

The introduction of the Prudential Code and uncertainty over future interest rates increases the risks associated with the treasury strategy should the council need to increase its use of short term borrowing or make further longer term borrowing on a variable rate. As a result the Council needs to take a cautious approach to its treasury strategy.

Long term fixed interest rates and base rates are both expected to remain very volatile in the short term and difficult to predict. Taking into account the interest rates shown in the table above, the most appropriate form of borrowing will be undertaken.

We intend to continue the current policy of meeting our long term borrowing requirements from the Public Works Loan Board. As part of the Comprehensive Spending Review on 20 October 2010, the interest rate on PWLB loans was raised from 0.2 percent to 1 percent above UK Government gilts. This will impact on any future decisions that the Council may make to borrow from the PWLB.

We will engage in short-term borrowing from the money market if necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. Wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable.

Investment Strategy 2012/13 – 2014/15

Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood that rates will remain at their current low levels, but again may change sharply as government act to deal with the economy changes. The most appropriate form of investments will be undertaken depending on the prevailing interest rates at the time, taking into account any associated rate risks.

All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations. The council's investment priorities are the security of capital and the liquidity of its investments

Annual Investment Strategy

Strategy Guidelines

The main principle governing the Council's investment criteria is the security and liquidity of its investments before yield, although the yield or return on the investment will be a consideration, subject to adequate security and liquidity. The Council must ensure:

- It has sufficient liquidity in its movements. For this purpose we will maximise the use of the council's online HSBC facility to place money either overnight or on a short-term basis.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counter parties with adequate security, and monitoring of their security.

A counter party list is maintained in compliance with this criteria and it will be revised and submitted to Council for approval as necessary. In accordance with new legislation, the proposed criteria detailed above are shown in the following subsections.

Liquidity of Investments

The Council expects to maintain average investment balances of £3.1m. The Council will continue to invest these on the London money market.

Specified Investments

These investments are sterling investments of not more than one-year maturity. These are low risk assets and the possibility of loss of principal or investment income is very low. The investments are defined as:

- The UK Government (such as the Debt Management Office, UK Treasury Bills or a gilt with less than one year to maturity).
- A local authority, parish council or community council.
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society). These bodies will have a minimum rating as set out in our counter party criteria and as listed in our Treasury Management Policy.

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 with these bodies. This criterion is also specified within the approved counter party criteria.

Non-Specified Investments

Non-specified investments include any other type of investments, i.e. not defined as specified above. These are sterling investments with:

- Securities admitted to the Officials List of the Stock Exchange that is guaranteed by the UK Government (such as supranational bonds).
- Gilt edged securities with a maturity of greater than one year.
- Institutions not meeting the basic security requirements under the specified investments.
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society) for deposits with a maturity of greater than one year.

At the present time the Council has no immediate plans to invest in non-specific investments.

Policy on the Use of Financial Derivatives

Many local authorities have previously made use of financial derivatives embedded in loans and investments both to reduce interest rate risk (i.e. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk. However, previous legislation was understood to prevent the use of such tools where they were not embedded in other instruments.

The Localism Act 2011 includes a general power of competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives. The latest CIPFA Code requires local authorities to clearly detail their policy on the use of derivatives in their annual strategy.

The Council has not and does not plan to use derivatives.

The Monitoring of Investment Counter parties

The credit rating of counter parties is monitored monthly. Any counter party failing to meet the criteria will be removed from the list immediately and, if required, new counter parties, which meet the criteria, will be added to the list.

Fitch credit ratings are monitored and are used as an indication of the probability of organisations defaulting on our investments. Whilst they only show an indication of the current credit position, they are being monitored on a regular basis and any significant changes will be reported to Policy and Finance Committee. It has previously been approved that investments with Building Societies be limited to the top 8 building societies based on their total assets.

The banks the Council use are reviewed annually as part of the Treasury Management policies and practices to take into account their Fitch IBCA long-term and short-term credit rating.

The Council has a policy to only use institutions with a short term Fitch rating of F2 or above

In addition to the Building societies and banks we use for investments, also approved for use is the United Kingdom Debt Management Office, where the Government guarantees investments.

Use of External Fund Managers

It is the Council's policy not to use an external fund manager.