REPORT FOR: CABINET

Date:	9 February 2012
Subject:	Treasury Management Strategy Statement, Prudential Indicators and Minimum Revenue Provision (MRP) Policy and Strategy 2012/13
Key Decision:	Yes
Responsible Officer:	Julie Alderson, Interim Corporate Director of Resources
Portfolio Holder:	Councillor Bill Stephenson, Leader and Portfolio Holder for Finance and Business Transformation
Exempt:	No
Decision subject to Call-in:	Yes
Enclosures:	Appendix 1 - Prospects for Interest Rates Appendix 2 - Treasury Delegations Appendix 3 - Revised Counterparty Policy

Section 1 – Summary and Recommendations

This report sets out the Council's Treasury Management Strategy Statement, Prudential Indicators and Minimum Revenue Provision (MRP) Policy for 2012/13

Recommendations:
The Cabinet is requested to recommend the Council to approve:

- The Treasury Management Strategy and Prudential Indicators; and
- The Minimum Revenue Provision Policy and Strategy for 2012/13.

That Cabinet refers this report to GARM Committee for review.

Reason
To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

Section 2 – Report

Introduction

1. Treasury Management is the management of the Council's investments and cash flows, its banking, money market and debt transactions together with the effective control of the risks associated with those activities.

2. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and Treasury Management Code of Practice to set treasury and Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

3. The Act therefore requires the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. CIPFA updated in 2011 both their Code of Practice and Prudential Code and the changes are fully reflected in this strategy statement.

4. It is a statutory requirement under the Local Government Finance Act 1992 for the Council to produce a balanced budget. The budget requirement for each financial year includes the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:-

   - increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
   - any increases in running costs from new capital projects

   are affordable within the projected income of the Council for the foreseeable future.

CIPFA Requirements

5. Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011). The primary requirements of the Code are as follows:

   (a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   (b) Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

   (c) Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

(d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

6. The 2011 revisions to the code of practice contain little material change. The main requirements that are relevant to Harrow are:

- The Treasury Policy Statement now requires high-level policies for borrowing and investments.
- A new treasury indicator on gross and net debt to highlight borrowing in advance of need.
- Interest reset dates on LOBO type loans to be treated as a maturity date.
- Inclusion of the HRA debt cap.

7. These changes are reflected in this report. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and the execution and administration of treasury management decisions to the S151 officer, who acts in accordance with the organisation's approved policy statement and TMPs. The Section 151 Officer chairs the Treasury Management Group (TMG) which consists of Deputy Section 151 Officer and the Treasury and Pensions manager, to monitor the treasury management activity and market conditions.

8. The Council has nominated GARM Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies. Further details of responsibilities are given in Appendix 2.

Treasury Management Policy Statement

9. The Council defines its treasury management activities as: "The management of the 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".

10. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

11. Harrow council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Treasury Management Strategy for 2012/13

12. The suggested strategy for 2012/13 is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services. The Strategy covers:-

    - treasury limits in force that will limit the treasury risk and activities of the Council
    - Prudential and Treasury Indicators
    - the current treasury position
    - prospects for interest rates
    - the borrowing strategy
    - policy on borrowing in advance of need
    - debt rescheduling
    - the investment strategy
    - creditworthiness and counterparty policy
    - the MRP strategy

13. The report on the Housing Revenue Account (HRA) is elsewhere on the agenda. It is not considered necessary to produce a separate treasury strategy for HRA in light of the proposed debt arrangements post HRA reform. Details of the future HRA treasury arrangements are contained in this report.

Treasury Limits for 2012/13 to 2014/15

14. It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

15. The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

16. The term an "Affordable Borrowing Limit", relates to the financing of capital plans by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

Prudential Indicators for 2012/13 to 2014/15

17. The Prudential Indicators are set out below.

    Table 1 shows the Council's treasury portfolio position as at 31 December 2011 and the limits for the maturity structure of fixed rate borrowing during 2011/12; and

    Tables 2 to 8 include estimates of capital expenditure; ratio of financing costs to the net revenue stream; Capital Financing Requirement; the incremental impact of capital decisions; the authorised limits and operational boundary for external debt; upper limit for fixed rate interest rate exposure and total sums invested for more than 364 days.

Table 1

Treasury position as at 31 December 2011		**Principal**		**Ave. rate**
		£m	£m	%
Fixed rate funding	PWLB	130.0		
	Market	131.8	261.8	**4.57**
Variable rate funding			0	
Other long term liabilities (PFI & leases)			21.7	
Total Debt			**283.5**	
Total Investments			**101.6**	**1.73**

In the table below, the maturity structure for debt for which the borrower has an option to increase the interest rate (and Harrow has the option to repay) is now shown as the first date that the interest rate can be increased. Previously the latest repayment date was used. The impact of this amendment is to increase the proportion of short maturity debt.

Maturity structure of fixed rate borrowing	**As at 31.12.2011**	**Upper limit**	**Lower limit**
Under 12 months	12.9%	20%	0%
12 months to 23 months	0%	20%	0%
24 months to under 5 years	25.2%	30%	0%
5 years to under 10 years	12.2%	40%	10%
10 years and over	49.7%	90%	30%

The Capital Prudential Indicators 2010/11 to 2014/15

18. The Council's capital expenditure plans are the key driver of the treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans. The indicators present in the table below are those suggested in best practice guidance. The Council can add or modify the indicators should this be appropriate.

Capital Expenditure and Funding

Table 2	2010/11	2011/12	2012/13	2013/14	2014/15
	actual	forecast outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure					
Non - HRA	52,645	41,429	44,932	36,398	29,813
HRA - settlement funding		89,000			
HRA - routine	5,302	8,187	8,997	7,941	8,342
TOTAL Expenditure	**57,947**	**138,616**	**53,929**	**44,339**	**38,155**
Funding:-					
Grants	26,101	17,153	9,666	9,279	7,764
Capital Receipts	5,462	6,921	9,822	7,126	2,454
Revenue Financing	290	0	425	826	2,170
Major Repairs Allowance	3,932	0	8,875	7,375	6,233
Total Funding	**35,785**	**24,074**	**28,788**	**24,606**	**18,621**
Borrowing to Fund the Capital Programme	**22,162**	**25,542**	**25,141**	**19,733**	**19,534**
Borrowing - HRA settlement		**89,000**			
Total new Borrowing	**22,162**	**114,542**	**25,141**	**19,733**	**19,534**

19. The above table summarises actual and expected capital expenditure plans and the sources of funding. Sources of funding being grants, capital receipts and in respect of HRA, major repairs allowance (MRA), which is an annual charge against revenue. The funding excludes Minimum Revenue Provision (depreciation on general fund assets) which offsets the need for external borrowing.

20. The net borrowing of £114.5 million in the current year is inflated by two items. Firstly, estimated borrowing of £89.0 million to pay the HRA settlement to Government. Secondly, the deferral of MRA from 2011-12 into the two following years (£4.1 million). Adjusting for these would reduce the borrowing value to £21.4 million in 2011-12, compared with the approved strategy of £24.0 million.

21. From 2012-13 onwards, HRA is at the Government imposed debt limit and new capital expenditure is fully funded from revenue. For the General Fund, borrowing for the period 2012-13 to 2014-15 includes self funding expenditure of £23.6 million which will only be initiated if projected revenue savings exceed capital financing costs.

Ratio of Financing Costs to Net Revenue Stream

Table 3	2010/11	2011/12	2012/13	2013/14	2014/15
	actual	forecast outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Ratio of financing costs to net revenue stream					
Non - HRA	12.95%	12.96%	12.88%	13.78%	13.05%
HRA	24.82%	8.57%	52.83%	47.28%	46.66%

22. The next section of the indicators considers the affordability of capital expenditure by comparing net interest costs and depreciation with net revenues. A rising allocation would be a concern as it would represent an increasing demand on resources. For the General Fund the ratio moves within a narrow range of 12-13%, despite net revenues declining by 4%. The General Fund benefits in 2012-13 from the impact of taking on the additional debt to fund the HRA reform, as the new borrowing incurs a lower interest rate than current debt.

23. The HRA ratio undergoes dramatic change following the finance reform, jumping from 25% in 2010/11 to 53% in 2012/13 due to the additional borrowing taken on to buy the council out of its annual subsidy payment. If the subsidy payment had been treated as a capital cost in 2010-11, the ratio for that year would have been 52%. The impact of the reforms is therefore to reduce HRA's "fixed" costs in 2013-14 and beyond. The indicator for 2011-12 is reduced by the decision not to charge MRA in the year. In the last two years, HRA capital expenditure is maintained at around the £8 million p.a. by utilising revenue surpluses.

Net Borrowing Requirements

Table 4	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**
	actual	**forecast outturn**	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Net borrowing requirement					
brought forward 1 April	182,054	195,898	297,546	311,355	315,347
carried forward 31 March	195,898	297,546	311,355	315,347	321,498
In year borrowing requirement	**13,844**	**101,648**	**13,809**	**3,992**	**6,151**

24. The net borrowing requirement looks at the change in debt less investment balances from year to year. The jump in the current year is due to the HRA settlement payment, while for future years the capital programme continues to require external borrowing.

Capital Financing Requirement

Table 5	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**
	actual	**forecast outturn**	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Financing Requirement as at 31 March					
Non – HRA	251,470	257,663	270,318	277,989	283,489
HRA	55,197	152,123	152,123	152,123	152,123
Total	**306,667**	**409,786**	**422,441**	**430,112**	**435,612**
Annual change in CFR					
Non – HRA	13,037	6,193	12,655	7,671	5,500
HRA	710	96,926	0	0	0
Total	**13,747**	**103,119**	**12,655**	**7,671**	**5,500**

25. The Capital Financing Requirement is the historic outstanding capital expenditure which has not been paid for or allocated to revenue. It is essentially a measure of the

Council's underlying borrowing need. Any capital expenditure which is not funded from revenue increases the CFR. The value of finance lease assets is included.

26. As discussed above, the General Fund CFR increase by £25.8 million as the capital programme (net of grants and receipts) exceeds MRP by that amount in the three years from 1st April 2012. For HRA, the increase in the current year is explained in paragraph 20 above (settlement payment and deferred MRA), with the balance constant thereafter.

27. Aggregate CFR estimated at 31st March 2012 of £409.8 million is in excess of actual external debt of £350.9 million due to internal balances used to part fund capital expenditure.

Incremental Impact of Capital Investment Decisions

Table 6	2010/11	2011/12	2012/13	2013/14	2014/15
	actual	forecast outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum	21.14	38.83	19.65	19.04	25.97
Increase in average housing rent per week	0.07	-14.00	21.93	-4.11	3.25

28. The incremental ratios compare the cost of debt and depreciation (MRP) linked to new capital borrowing with expected levels of council tax and rents. A high or growing ratio would suggest that council taxes or rents will have to increase to fund the capital expenditure programme. The ratio ignores the favourable impact of assets that have become fully depreciated and drop out of the depreciation charge, resulting in an overstatement of the impact.

29. For the General Fund, the ratio is lower than last year's strategy and the recent half yearly report. Capital receipts are firstly applied to offset MRP on short life assets. The decrease in anticipated capital receipts in 2014-15 is the cause of the increased impact in that year due to higher MRP on new assets. The HRA values are impacted by the ending of the HRA subsidy scheme, but looking across 2011-12 to 2014-15 the impact is £7.14 per week, wholly due to the use of revenue balances of £2.4 million in the last two years to fund capital expenditure.

Ratio of Net to Gross Borrowing

Table 7	2010/11	2011/12	2012/13	2013/14	2014/15
	actual	forecast outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Net to Gross Debt Limit					
Gross borrowing	278,908	374,100	375,254	372,940	372,226
Net borrowing	195,898	297,546	311,355	315,347	321,498
Net debt percentage	70%	80%	83%	85%	86%
Minimum ratio		75%	75%	75%	75%

[NB WLWA balances are excluded from debt (£3 million) and cash (£15 million)

30. This is a new indicator and is designed to highlight borrowing in advance of need, for example when substantial investment balances are held. Harrow's ratio is expected to remain fairly stable. New debt of £50 million was raised in 2010 to support the capital programme at favourable interest rates of 3.74%. Projected cash balances of £76.6 million as at 31 March 2012 (excluding third party balances) will be used to support the capital programme in the following three years and to repay borrowing in 2014 (£16 million).

Borrowing and Investment Limits

Table 8	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**
	actual	**forecast outturn**	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Authorised Limit for external debt	**£'m**	**£'m**	**£'m**	**£'m**	**£'m**
Borrowing	262	351	353	353	353
Other long term liabilities	26	26	27	25	24
Total	**288**	**377**	**380**	**378**	**377**
Operational Boundary for external debt					
Borrowing	262	351	361	370	372
Other long term liabilities	26	26	27	25	24
Total	**288**	**377**	**388**	**395**	**396**
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	262	373	383	391	393
Upper limit for variable rate exposure					
Net principal re variable rate borrowing/Investments	0	0	0	0	0
Upper limit for principal sums invested over 364 days	18	13	25	25	25

31. The final set of indicators is the debt and investment limits. The operational boundary is based on current debt plus the net impact of capital expenditure in excess of depreciation, and indicates no requirement for new debt in the period. The authorised limit also builds in a provision for delayed capital receipts.

32. It is anticipated that all borrowing will be fixed rate and that the limit for investments maturing in excess of twelve months is retained at £25 million.

Interest Rate Outlook and Economic Background

33. The base rate has remained unchanged at 0.5% since March 2009. The Council has appointed Sector as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 2011/ 2012 0.50%
- 2012/ 2013 0.50%
- 2013/ 2014 1.25%
- 2014/ 2015 2.50%

34. Appendix 1 sets out Sector's forecasts for short term (Bank Rate) and longer fixed interest rates together with comments on the economic background. The Bank base

rate is anticipated to remain unchanged until Q3, 2013 and to rise steadily thereafter. With growth in the UK expected to remain weak for a prolonged period as both government and individuals seek to reduce debt, the risk probably lies on the side of delayed rate increases. UK inflation is expected to subdue in 2012 reducing the pressure on the Bank of England to reduce rates.

35. The impact of continued low base rates will be felt on investment income where call and money market rates track base rates. Deposits with maturities of 12 to 36 months offer significantly higher returns (up to 3% more than instant access funds).

36. A similar picture is expected on the borrowing side with 50 year PWLB rates anticipated to increase from 4.26% at present (December 2011) to 5.30% by March 2015. Borrowing rates are historically attractive and are expected to remain at similar levels for the remainder of 2012. There remains a risk that the Government's targets to reduce the deficit will be missed leading markets to demand higher gilt rates.

37. The spread between investment returns and borrowing rates continues to entail a cost if borrowing is made in advance of needs.

Borrowing Strategy

38. The Council's borrowing strategy will give consideration to new borrowing in the following order of priority:-

    (a) The cheapest borrowing is currently internal borrowing by running down cash balances and foregoing interest earned at historically low rates. Current projections of capital receipts and expenditure indicate that no external borrowing will be required for at least for the next two years. However, if projected capital expenditure increases, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years. This is particularly relevant to the HRA settlement.

    (b) Temporary borrowing from the money markets or other local authorities to cover mismatches in timing between capital receipts and payments.

    (c) Fixed rate market loans, most probably PWLB although other sources of debt may be available. Further LOBO loans are unlikely in the current low interest environment.

39. The main advantages of using internal borrowing are (i) that short term interest rates on investments are considerably lower than the cost of borrowing, particularly long term, and (ii) the reduction of investment balances also has the benefit of reducing the exposure to interest rate and counterparty risks.

40. The Council has borrowed £83.8 million under Lender Option, Borrower Option (LOBO) structures with maturities between 2050 and 2078. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and half yearly thereafter) to reset the interest rate. If the rate of interest is changes, Harrow is permitted to repay the loan at no additional cost. Guidance issued in November 2011 by CIPFA requires that such

borrowing be shown as maturing at the first date that the borrower can amend the interest charge. This has considerably shortened the maturity profile of the debt portfolio as shown in paragraph 17. The change in guidance does not indicate an increased likelihood of interest rates changes on LOBO debt. No change has been made to the maturity ranges, which means that no further LOBO loans will be permitted. The upper limit on 0-12 month debt will **not** be breached in 2012-13, but will do so in later years when all the LOBO loans reach the first date on which interest rates can be reset.

Housing Revenue Account

41. Harrow currently pays the Government £7.0 million p.a. under the HRA subsidy system. The Government is abolishing these arrangements in exchange for a one off payment by Harrow estimated at £89.0 million on 28th March 2012. The payment to the government could be funded from existing cash balances or new external borrowing. It is intended to fully fund the payment using PWLB debt to take advantage of the low cost funds available. Not only are gilt yields at post war lows but the margin over gilt yields charged on PWLB borrowing for settlement purposes has been reduced from the standard 1% to 0.15%, a saving of 0.85% p.a. Current cash balances are required to cover debt maturities and net capital expenditure in the next 2-7 years. Other sources of debt have been investigated, but are more expensive than the PWLB. Funding using LOBO structures was considered to be excessively risky with interest rates expected to increase significantly in future.

42. Short term savings could be made by funding some or all of the settlement payment through short term (10 year) debt rather than longer term (50 year) debt and refinancing the settlement debt in 2022. Interest costs are expected to increase steeply such that over a 50 year period the additional interest cost from taking 10 year debt initially and refinancing is £65 million. Although the HRA business plan anticipates revenue surpluses from year 10 onwards, this may be used to support new capital spend and will not necessarily be available to repay debt. Using debt maturities between 20 & 40 years also leads to additional costs compared to 50 year debt.

43. The sharing of the cost of debt between the General Fund and the HRA is an important decision for the Council. Councils have freedom to develop their own approach provided it is (1) fair to both the GF and HRA, and (2) is approved by full Council. Two approaches have emerged – one pool and two pools. One pool involves combining all existing and new debt and allocating a proportion to HRA based on its capital balance. The two pool approach is to allocate HRA a share of existing debt based on pre settlement capital together with all the new debt acquired for settlement purposes.

44. A single debt pool is preferred as it will maximise flexibility ensuring that HRA is only charged for the level of capital it holds. There is then no risk of the HRA being over or under borrowed. Also it enables debt to be switched to the GF if HRA generates surplus, which will support the repayment of existing debt.

45. The HRA's maximum level of debt as measured by its capital finance requirement under the new self financing arrangements will equal the CFR of the HRA as at 31st March 2012, projected at £152.2 million.

Non HRA Borrowing in 2012-13

46. In the current environment caution will be adopted with regard to the treasury operations. The Treasury Management Group will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet at the first available opportunity. No non HRA borrowing is expected in the year, with sufficient cash held to fund the capital programme.

47. 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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

Debt Rescheduling

48. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

49. Should any of the LOBO loans with interest rate reset dates in 2012-13 (£33.8 million) require refinancing, the most likely source will be a combination of internal cash and external borrowing to protect the budget. The ratio will depend on the relative cost of the existing and replacement debt.

50. As short term borrowing rates are considerably cheaper than longer term rates, there may be some residual 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 size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature. Any such rescheduling and repayment of debt is likely to cause a flattening of the Council’s maturity profile as in recent years there has been a skew towards longer dated borrowing.

51. 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 strategy outlined above, and
- to enhance the balance of the portfolio, in particular the maturity profile.

52. Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are lower than rates paid on current debt. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

Annual Investment Strategy

Investment Policy

53. The Council approves a Treasury Management Strategy on an annual basis and has adopted the 'CIPFA code of Practice for Treasury Management in the Public Services'.

54. The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

    (a) The security of capital, and
    (b) The liquidity of its investments.

55. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the Council is low in order to give priority to security of its investments.

56. The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

Creditworthiness and Counterparty Policy

57. Following changes to the credit ratings of most of the UK High Street banks in the Autumn of 2011, a revised creditworthiness and counterparty policy was supported by GARM Committee and approved by Cabinet in December 2011. The revised policy has not yet been implemented as it requires full Council approval. The table below reflects the amended policy approved in December 2011. For completeness, Appendix 3 highlights the changes that were made to the policy.

58. The Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Specified investments are considered low risk and relate to funds invested for up to one year. Non-Specified investments normally offer the prospect of higher returns but carry a higher risk and may have a maturity beyond one year. All investments and borrowing are sterling denominated.

Specified Investments

59. All such investments will have maturities up to maximum of 1 year, meeting the minimum rating criteria where applicable. The instruments and credit criteria to be used are set out in the table below.

Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1+Short-term 2 Support B Individual AAA Sovereign	In-house
Money Market Funds	AAA	In-house

Non-Specified Investments

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – banks and building societies	A Long Term F1 Short-term 1 Support B Individual UK or AAA Sovereign	In-house	50%	3 months
UK nationalised Banks [RBS & Lloyds / HBOS]	F1 Short-term 1 Support	In-house	30% for each of the two Groups	36 months
Callable Deposits	F1 Short term A Long Term 1 Support	In-house	20%	3 months

60. Individual bank & building society counterparty limits that are consistent with the above limits are approved by the Section 151 Officer in accordance with the Council's Treasury Management Practices. Other than the two UK nationalised banks (Lloyds / HBOS and RBS), each counterparty has a £20 million limit. For the two UK nationalised banks the individual limit will be the lower of £30 million or 30% of the aggregate investment value.

61. Maturities for term deposits with banks and buildings societies that meet the credit quality threshold for specified investments will also be restricted to three months. No change will be made without Cabinet approval and support from GARM Committee.

62. All credit ratings will be monitored in house with the help of Sector who alert the Council to changes in credit ratings through its creditworthiness service.

63. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use as an investment will be withdrawn immediately.

Investment Strategy

64. The Council's funds are mainly cash flow derived and include the General Fund, West London Waste Authority and Housing Revenue Account balances. Balances are also held to support capital expenditure. From 1st April 2011, pension fund cash

balances have been held separately from those of the Council. A separate investment strategy has not been developed for the pension fund. All its cash (circa £21 million as at December 2011) is held on overnight call account with RBS.

65. The revised counterparty policy recognises the greater uncertainty within the financial sector by limiting deposits to three months for those banks that are not UK government owned. Selective deposits with maturities of over three months will be made with the Lloyds / HBOS and RBS to obtain the benefit of the higher rates on offer provided that prudent liquidity is maintained. In no event will more than £25 million be invested for maturities of more than 12 months.

66. Due to the low interest rates environment and to reduce the exposure to counter party risk, it is anticipated that cash balances will continue to decline as internal borrowing is utilised to fund the capital programme for 2012/13. Investment income (net of allocations) has been budgeted at £807,000 in 2012/13 (2011/12 £1,293,000) reflecting both lower anticipated balances and the impact of the three month maximum maturity for most counterparties.

Minimum Revenue Provision

What is a Minimum Revenue Provision?

67. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP), which was previously determined under Regulation, and will in future be determined under Guidance. The purpose of MRP is to enable the Council to make prudent provision to redeem its debt liability over a period that is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

68. The Council is required to determine an amount of minimum revenue provision that it considers to be prudent. There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year. The share of Housing Revenue Account CFR has not been the subject to an MRP charge in current or prior years.

Minimum Revenue Provision Policy Statement 2011/12

69. The Council will assess their MRP for 2011/12 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

70. MRP on assets acquired before April 2008 will continue to be charged at the rate of 4%, in accordance with the guidance. Where appropriate, capital assets acquired after April 2008 will be subject to MRP charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method (or annuity method if preferred). For example, capital expenditure on a new building, or on the refurbishment or

enhancement of a building, will be related to the estimated life of that building or in the case of refurbishments, on the life of the expenditure.

71. When adopting this aspect of the recommendations contained within the guidance, the Council will, where applicable, treat any new capital expenditures schemes which are both commenced and finalised within the financial year as having been financed from any associated grants or similarly earmarked funds. However, the amount of resources available and used for financing in accounting terms within each financial year will be fully allocated within that year, which means that in cases where expenditure is incurred on only part of a scheme which is not completed by the year end, any grant or similar financing resources will be allocated to other new expenditures under delegated powers.

72. Estimated life periods will be determined under delegated powers and will generally follow those set out in the guidance. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate:

- In the case of new capital expenditures which serve to add to the value of an existing capital asset, these will be estimated to have the remaining useful life as the asset whose value is enhanced.

- To the extent that expenditures are of a type that are subject to estimated life periods that are referred to in the Guidance, these periods will generally be adopted by the Council. However, in the case of long term debtors (e.g. West London Waste Authority) arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no Minimum Revenue Provision made. The Council is satisfied that a prudent provision will be achieved after exclusion of these capital expenditures from the MRP requirements.

73. The determination as to which schemes shall be deemed to be financed from available resources, and those which will remain as an outstanding debt liability to be financed by borrowing or other means, will be assessed under delegated powers.

<u>HRA Major Repairs Allowance</u>

74. No revenue charge is currently required for the HRA. However under HRA reform there will be a requirement to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.

75. The Council will not charge depreciation on its assets for the next five years as the value of the housing stock will be maintained or improved through regular maintenance and enhancements. Beyond April 2017, provision to repay borrowing will be made if future asset lives are not being maintained. As the value of the housing stock is expected to increase broadly in line with inflation, HRA debt as a proportion of the value of the housing stock will decline.

Financial Implications

76. Financial matters are integral to the report.

Environmental Impact

77. There are no direct environmental impacts.

Performance Issues

78. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function.

Risk Management Implications

79. There is a risk that the Council could lose a deposit due to the failure of a Counter Party and any movement in interest rates will have an impact on the investment income and borrowing costs.

Risk included on Directorate risk register? Yes
Separate risk register in place? No

Equalities Implications

80. There is no direct equalities impact.

Corporate Priorities

81. This report deals with the Treasury Management Strategy which is a key to delivering the Council's corporate priorities

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 24 January 2012	√	Chief Financial Officer
Name: Jessica Farmer Date: 24 January 2012	√	on behalf of the Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Alex Dewsnap	√	Divisional Director
Date: 23 January 2012		

Section 5 – Environmental Impact Officer Clearance

Name: John Edwards	√	Divisional Director
Date: 20 January 2012		

Section 6 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager, Finance & Procurement) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: N/A

Call-In Waived by the Chairman of Overview and Scrutiny Committee	**NOT APPLICABLE** *[Call-in applies, except to the Recommendations to Council]*

Appendix 1

Interest Rates and Economic Background

The Council has appointed Sector 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 Sector central view.

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
Mar 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec2012	0.50	0.70	1.60	2.40	4.30	4.40
Mar2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
Mar 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved

This challenging and uncertain economic outlook has a several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully; and
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

Appendix 2

Treasury Management Delegations and Responsibilities

The respective roles of the Cabinet, GARMC, the Section 151 officer, the Treasury Management Group and the Treasury Team are summarised below. Further details are set out in the Treasury Practice Notes.

The main responsibilities and delegations in respect of treasury activities are:

Council

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management and in doing so have regard to the Prudential Code

Council has delegated responsibility for the implementation and regular monitoring of treasury management policies and practices to Cabinet

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

Governance, Audit and Risk Monitoring Committee

GARMC is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

Section 151 Officer

Council has delegated execution and administration of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. In particular, the Sector 151 Officer:

- Approves all new borrowing, investment counterparties and limits and changes to the bank mandate,
- Chairs the Treasury Management Group ("TMG"), and
- Approves the selection of treasury advisor and agrees terms of appointment.

Treasury Management Group

Monitors the treasury activity against approved strategy, policy, practices and market conditions.

Approves changes to treasury management practices and procedures.

Review the performance of the treasury management function using benchmarking data on borrowing and investment provided by Sector.

Monitors the performance of the appointed treasury advisor and recommends any necessary actions.

Ensures the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.

Monitors the adequacy of internal audit reviews and the implementation of audit recommendations.

<u>Treasury Team</u>

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures and recommends changes to these to the TMG.

Proposed Revised Counterparty Policy

Specified Investments

All such investments will have maturities up to maximum of 1 year, meeting the minimum rating criteria where applicable. The instruments and credit criteria to be used are set out in the table below.

Instrument	**Minimum Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1+Short-term 2 Support B Individual AAA Sovereign	In-house
Deleted		
Money Market Funds	AAA	In-house

Non – specified Investments

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
Term deposits – banks and building societies	**A** Long Term **[AA-]** **F1** Short-term **[F1+]** **1** Support **[2]** B Individual **UK** or AAA Sovereign	In-house	50%	3 months [5 years]
UK nationalised Banks [RBS & Lloyds / HBOS]	**F1** Short-term **[F1+]** **1** Support **[2]**	In-house	30% for each of the two Groups	36 months
Callable Deposits	**F1** Short term **[F1+]** A Long Term **1 Support**	In-house	20%	3 months [5 years]

Ratings in bold have been altered. Those in [ ] are the current approved policy.