## 1.1 Background

The Authority is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Authority's low risk appetite, providing adequate liquidity before considering investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing needs of the Authority, essentially the longer term cash flow planning to ensure that the Authority can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

Treasury Management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:

"The management of the local authority's investments and cash flows, its banking, money market and capital transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

## 1.2 Reporting Arrangements

In line with best practice, full Council is required to receive and approve the Prudential and Treasury Indicators and Treasury Strategy each year in relation to the general fund. For the Housing Revenue Account these are approved by Cabinet. This report covers the Housing Revenue Account (HRA) Treasury Management Strategy detailing how investments and borrowing are to be organised, including HRA treasury indicators, and an HRA investment strategy;

There are two other main reports each year, which incorporate a variety of policies, estimates and actual which are approved by Cabinet. These reports are:

- **A Mid - Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision; and

- **An Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

## 1.3 HRA Treasury Management Strategy for 2013/14

The proposed HRA strategy for 2013/14 in respect of the following aspects of the treasury management function is based upon the treasury officers' view on interest rates, supplemented with market forecasts provided by the Authority's treasury adviser, Sector.

This strategy covers:

- The current treasury position;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- Annual investment strategy;
- Creditworthiness policy; and,
- Policy for the use of external service providers.

## 1.4 Current Treasury Position

The Authority's treasury position at 02 January 2013 is set down in Table 1 below. This has been compared with the comparable position as at 12 January 2012.

**Table 1: Current Treasury Position**

| | Principal Outstanding | Average Rate | Principal Outstanding | Average Rate |
|---|---|---|---|---|
| | (02 Jan 2013) £m | % | (12 Jan 2012) £m | % |
| **Fixed Rate Funding** | 264.750 | 5.70 | 274.750 | 5.54 |
| PWLB* | 128.193 | 3.49 | | |
| PWLB – HRA | 20.000 | 4.35 | 20.000 | 4.35 |
| Settlement 2012 | 28.173 | 0.34 | 25.000 | 1.15 |
| Market Loans | | | | |
| Temp Loans | | | | |
| **Total External Debt** | **441.116** | | **319.750** | |
| *less* **Investments** | | | | |
| (UK) Banks | | | | |
| (UK) DMO** | 10.100 | 0.25 | 12.350 | 0.25 |
| Other LA's*** | | | | |
| **Total Investments** | **10.100** | | **12.350** | |
| | | | | |
| **Net Position** | **431.016** | | **307.400** | |

***Public Works Loan Board**
****Debt Management Office**
*****Other Local Authorities**

## 1.5 Prospects for Interest Rates

The Authority has appointed Sector as it's treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Regular meetings are held with Sector to discuss the Authority's treasury options; all major investment and borrowing decisions consider the professional advice offered by Sector.

Appendix D(iv) of this report sets out Sector's professional view of interest rate forecasts. Appendix D(v) draws together a number of current City forecasts for short term or variable, and longer fixed interest rates.

Table 2 below gives the Sector central view.

**Table 2: Sector forecast for PWLB new borrowing**

| | Mar 2013 % | June 2013 % | Sept 2013 % | Dec 2013 % | Mar 2014 % | June 2014 % | Sept 2014 % | Dec 2014 % | Mar 2015 % |
|---|---|---|---|---|---|---|---|---|---|
| Bank Rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 |
| 5 yr PWLB | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.70 | 1.80 | 2.00 | 2.20 |
| 10 yr PWLB | 2.50 | 2.50 | 2.60 | 2.60 | 2.70 | 2.70 | 2.80 | 3.00 | 3.20 |
| 25 yr PWLB | 3.80 | 3.80 | 3.80 | 3.80 | 3.90 | 3.90 | 4.00 | 4.10 | 4.30 |
| 50 yr PWLB | 4.00 | 4.00 | 4.00 | 4.00 | 4.10 | 4.10 | 4.20 | 4.30 | 4.50 |

The UK continues its worst and slowest recovery from recession in recent history. Growth prospects are weak, although the economy did come out of recession in the third quarter of 2012. Consumer spending, the driving force of recovery, is likely to remain under pressure due to the repayment of personal debt, general malaise about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth.

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

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality lower risk counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2013/14 and beyond;

- Borrowing interest rates continue to be attractive and may remain relatively 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.

## 1.6 HRA Borrowing Strategy

The Authority is currently maintaining an “under-borrowed” position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Authority’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high.

The Authority’s HRA borrowing strategy will give consideration to new borrowing in the following order of priority:-

- The cheapest borrowing and lowest risk approach is internal borrowing. By continuing to maintain a relatively low level of cash balances the risk of investment is reduced and the historically low rates of interest means that the interest foregone is lower than in previous years. However, 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.

- Temporary borrowing from the money markets or other local authorities.

- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

- PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt.

- PWLB borrowing for periods of longer than 10 years may be explored.

The principal risks that impact on the strategy are the security of the Authority's investments and the potential for sharp changes to long and short term interest rates. Officers, in conjunction with the Authority's treasury advisor, will continue to monitor the financial standing of banks and building societies on the counterparty list, and the level of interest rates, both those prevailing and forecast.

Against this background caution will be adopted with the 2013/14 HRA treasury operations. The Strategic Director of Finance and Resources will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet or full Council, as appropriate, at the next available opportunity. Such circumstances include a situation where:

- If it were felt that there was a significant risk of a sharp fall in long and short term interest rates, perhaps due to marked increases 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 funding will be considered; or

- If it were felt there was a significant risk of a sharp rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase 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 relatively cheap.

## 1.7 Policy on borrowing in advance of need

The Authority 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 Authority can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Authority will;

- Ensure that there is a clear link between the HRA capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;

- Ensure the ongoing HRA revenue liabilities created, and the implications for the future plans and budgets have been considered;

- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;

- Consider the merits and demerits of alternative forms of funding;

- Consider the alternative interest rate bases available, the most appropriate periods to fund the repayment profiles to use; and,

- Consider the impact of borrowing in advance temporarily increasing investment cash balances and the consequent increase in exposure of counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

## 1.8 HRA Debt Rescheduling

As short term borrowing rates are expected to be considerably cheaper than longer term 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 size of the premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any position taken via rescheduling will be in accordance with the strategy position outlined above.

In order to generate the most attractive debt rescheduling opportunities, it is proposed that the strategy for 2013/14 should remain flexible. The reason for any rescheduling to take place may include:

- the generation of cash savings at minimum risk;

- to help fulfil the strategy outlined above; and

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

All rescheduling will be reported to Cabinet as part of the next budget monitoring report at the meeting following its action.

## 1.9 HRA Annual Investment Strategy 2013/14

This Authority has regard to the CLG's Guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Authority's investment priorities are:

a) the security of capital;
b) the liquidity of its investments; and,
c) return.

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

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activities.

The HRA Investment Strategy states which instruments the Authority may use for investment purposes, making a distinction between specified and non-specified investments. This is set out in Appendix D(vi). The Authority's current counterparty list is set out in Appendix D(i) and D(ii) of the report.

In order to develop an investment strategy for the next financial year, it is necessary to take a view on future interest rate movements. Professional advice is sought from Sector, the Authority's treasury advisor. Bank Rate has been unchanged at 0.50% since March 2009. As set out in Appendix D(iv), Sector is forecasting that the Bank Rate is to remain unchanged at 0.50% during 2013/14 before starting to rise from  March2015. Bank Rate forecasts for financial year ends (March) are as follows:

- 2012-13 0.50%
- 2013-14 0.50%
- 2014-15 0.75%
- 2015-16 1.50%

There is a downside risk to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England 2% target rate.

The strategy for 2012/13 agreed on 1 March 2012 was set in a background of uncertainty and a prudent approach was taken with nearly all investments on an overnight basis. In the current economic climate it is essential that a prudent approach is maintained. This will primarily be achieved through investing for up to three months with selected banks and funds which meet the Authority's credit rating criteria, set out in Appendix D(vi).

The Authority will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the full Council.

It is also important to recognise that movements within the money markets can happen with no notice and the Strategic Director of Finance and Resources may have to amend this strategy in order to safeguard the funds of the Authority. Any such actions will be reported to Cabinet as part of the next budget monitoring report at the meeting following this action.

The Strategic Director of Finance and Resources will undertake the most appropriate form and duration of investments depending on the prevailing interest rate at the time, taking into account the risks shown in the interest rate forecast.

All investments will be made in accordance with the Authority's HRA investment policies and prevailing legislation and regulations.

At the end of the financial year, the Authority will report on its investment activity as part of its Annual Treasury Report.

## 1.10 HRA Creditworthiness Policy

Credit ratings will continue to be monitored by the Authority's treasury management team. The Authority is alerted to changes to ratings through its use of the Sector creditworthiness service who notify the Authority of any changes as soon as they receive the information. The Sector creditworthiness service uses a modelling approach with credit ratings from the three main rating agencies – Fitch, Moody's and Standard and Poor's, forming the core element. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system. Where an institution has its credit rating downgraded so that it fails to meet the Authority's credit criteria then:

- no new investments will be made after the date of notification,
- any investments 'on call' will be recalled immediately.

Where an institution is placed on negative rating watch (notification of a possible rating downgrade) deposits will continue to be made up to approved limits so long as the institution's credit quality is above the Authority's minimum criteria.

Sole reliance will not be placed on the use of this external service. In addition this Authority will also use market data and market information, information on government support for banks and the credit ratings of the government support.

## 1.11 HRA Policy on the use of external service providers

The Authority uses Sector Treasury Services as its external treasury management advisers.

The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

The Authority 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 Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.