APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2013/2014

Introduction

In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice Fully Revised 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

Treasury Borrowing Limits for 2013/14 to 2015/16

It is a statutory duty under s.3 of the Local Government Act 2003, and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. This amount is termed the 'Affordable Borrowing Limit'.

The Council must have regard to the Prudential Code when setting the Affordable Borrowing Limit. The Code requires an authority to ensure that its total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

The Affordable Borrowing Limit must include all planned capital investment to be financed by external borrowing and any other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is to be set on a rolling basis for the forthcoming year and two successive financial years.

Treasury Management Indicators for 2013/14 – 2015/16

The Council measures and manages its exposures to treasury management risks using the following indicators. The council is asked to approve the following indicators:.

<u>Security: average credit rating</u>
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	2013/14
Minimum Portfolio average credit rating	A

Interest rate exposures
This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2013/14	2014/15	2015/16
Upper limit on fixed interest rate exposures	£201m	£196m	£193m
Upper limit on variable interest rate exposures	£60m	£60m	£60m

The variable interest rate exposure limit is set at £0m to restrict the amount of variable rate debt up to the level of variable rate investments.

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing
This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within five years	75%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than 364 days
The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the proportion of total principal sum invested to final maturities beyond the period end will be:

	2013/14	2014/15	2015/16
Limit on proportion of principal invested beyond year end	£50m	£50m	£50m

Borrowing limits
The Authorised limits for external debt include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over and above the operational limit for unusual cash movements.

The Operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements. This level also factors in the proposed approach to use internal cash-flow and future capital receipts as the preferred financing method for the capital programme.

	2013/14	2014/15	2015/16
Operational boundary – borrowing	£167m	£156m	£159m
Operational boundary – other long-term liabilities	£2m	£2m	£2m
Operational boundary – TOTAL	£169m	£158m	£161m
Authorised limit – borrowing	£201m	£196m	£193m
Authorised limit – other long-term liabilities	£2m	£2m	£2m
Authorised limit – TOTAL	£203m	£198m	£195m

Current Portfolio Position
The Council's treasury portfolio position at 31st December 2012 comprised:

	Principal	Ave. rate
	£m	%
Total Fixed rate funding	PWLB 100	4.45
Variable rate funding	Market 20	4.50*
Other long term liabilities	Nil	N/A
TOTAL DEBT	**120**	**4.46**
TOTAL INVESTMENTS**	**89.9**	**0.67**
NET DEBT	**30.1**	

* The market loans are 'lenders options' or LOBO's. These are fixed at a relatively low rate of interest for an initial period but then revert to a higher rate of 4.5%. When the initial period is over the loans are then classed as variable, as the lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower has the option to repay the loan without penalty.
** Total Investments includes Schools balances where schools have not opted for an external bank account and cash balances related to B&NES PCT Pooled budgets and West of England Growth Points funding.

Prospects for Interest Rates

The Council has appointed Arlingclose as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following section gives their commentary on the economic context and views on the prospects for future interest rates.

Economic Context

Despite some stronger economic growth data towards the end of 2012, consumers are yet to loosen their purse strings and businesses are still reticent to make long-term investment decisions. The momentum in GDP growth developed in the Olympics-affected third quarter is therefore unlikely to be sustained while uncertainty over the economic outlook persists. Consumer Price Inflation has picked up from the low of 2.2% in September to 2.7% in December and it is expected to be affected by volatility in energy and commodity prices throughout 2013.

The Bank of England's Monetary Policy Committee is monitoring current economic conditions after voting not to extend quantitative easing in November. Policymakers appear to be hoping the Funding for Lending Scheme (FLS), which started in August, is more effective at easing restricted credit conditions. Although HSBC has opted out of the scheme, most of the UK's biggest lenders have now signed up. There has been some indication in recent data that the FLS is beginning to boost lending to the household sector, but business lending remains relatively subdued. Further asset purchases remain a distinct possibility, although above target inflation may constrain the MPC in the near future. Based on the last Inflation Report, Bank of England policymakers believe there is a good chance that the CPI rate will remain above target throughout 2013.

The US Federal Reserve has responded to the slowdown in growth and employment with large scale asset purchases of $85bn a month until the outlook for the labour market improves substantially. The US public finance 'fiscal cliff' remains a serious risk despite the last minute deal reached before the deadline at the end of December. The political turmoil is likely to return in February when the talks on increasing the debt ceiling will create a stage for further political brinkmanship, no doubt prompting further volatility in financial markets.

The Eurozone is making slow headway, with the European Stability Mechanism now operational, announcements on the Outright Monetary Transactions programme well received, and some progress being made towards banking union. These have placated markets and curtailed some of the immediate risks to the stability of the monetary union. A sustainable solution to the Eurozone crisis is some way off though, as fiscal integration and mutualisation of Eurozone sovereign debt liabilities remain politically unpalatable.

Interest rate forecasts

The Council's treasury management adviser, Arlingclose, believes that it could be 2016 before official UK interest rates rise. The US Federal Reserve has signalled it will keep interest rates "at exceptionally low levels" until at least 2015. The UK's safe haven status and the minimal prospect of short-term rate rises should maintain gilt yields near their current lows.

Arlingclose and Markets Interest Rate Forecasts

Arlingclose central interest rate forecast – December 2012

	Bank Rate	3 month LIBID	12 month LIBID	20-year gilt yield*
Q1 2013	0.50	0.40	0.90	2.80
Q2 2013	0.50	0.40	0.90	2.80
Q3 2013	0.50	0.40	0.95	2.80
Q4 2013	0.50	0.45	0.95	2.80
H1 2014	0.50	0.50	1.00	2.90
H2 2014	0.50	0.50	1.00	2.90
H1 2015	0.50	0.55	1.10	3.00
H2 2015	0.50	0.60	1.10	3.00

* The Council can currently borrow from the PWLB at 0.80% above gilt yields

HM Treasury Survey of Forecasts – November 2012

	Average annual Bank Rate %			
	2013	2014	2015	2016
Highest	0.60	1.60	2.80	3.60
Average	0.50	0.65	1.30	1.80
Lowest	0.25	0.25	0.50	0.50

The Council has budgeted for interest rates to remain constant at 0.75% for 2013/14 & beyond.

Borrowing Strategy

The Council currently holds £120 million of long-term loans, and we will continue to monitor appropriate opportunities for borrowing in line with the overall Capital Financing Requirement.

The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2013 is expected to be £161 million, and is forecast to rise to £201 million by March 2014 as capital expenditure is incurred.

The maximum expected long-term borrowing requirement for 2013/14 is:

	£m
Not borrowed in previous years	*41*
Forecast increase in CFR	*40*
Loans maturing in 2014/15	*0*
TOTAL	***81***

However, based on current expectations for interest rates, it is likely that the Council will not undertake any new borrowing , reducing the size of the Council's investment balance instead. The capital financing budget for borrowing in 2013/14 assumes no new borrowing is taken during the year.

In addition, the Council may borrow for short periods of time (normally up to two weeks) to cover unexpected cash flow shortages.

Sources of borrowing
The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- any institution approved for investments that meets the investment criteria (this includes other local authorities)
- any other bank or building society approved by the Financial Services Authority
- Public or Private Bond Placement
- Special purpose companies created to enable joint Local Authority bond issues.

Debt instruments
Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest.
- lender's option borrower's option (LOBO) loans.
- bonds

As an alternative to borrowing loans, the Council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative

Planned Borrowing strategy for 2013/14

With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective for the foreseeable future not to take on new borrowing and reduce the level of investments held instead.

The Public Works Loan Board allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council will review opportunities to take advantage of this and replace these higher fixed rate loans with new loans at lower, fixed or variable interest rates, where this will lead to overall budget savings or reduce risk.

All rescheduling will be reported in the next available Treasury Management Monitoring report following its action with all rescheduling detailed in the annual review report.

Policy on use of Financial Derivatives
Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

The Localism Bill 2011 includes a general power of competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

<u>Derivative counterparties</u>
Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.