City of Westminster

Committee Report

Decision Maker:	Housing, Finance and Customer Services Policy & Scrutiny Committee
Date:	Monday 26 January 2015
Classification:	For General Release
Title:	Treasury Management Strategy for 2015/16, including Prudential Indicators and Statutory Borrowing Determinations
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently
Financial Summary:	The Annual Treasury Management Strategy sets out the Council's strategy for investing its cash balances, and borrowing within appropriate risk parameters. The Council's investment priorities are to ensure the security of capital, the liquidity of its investments and an optimum return on its investments commensurate with proper levels of security and liquidity, while financing the Council's capital programme and ensuring that cash flow is properly planned. The strategy also sets out the Council's guidelines for ensuring the Council's capital investment plans are prudent, affordable, and sustainable.
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1. EXECUTIVE SUMMARY

1.1 The Council is required under the Local Government Act 2003 (as amended) and other regulations to approve an Annual Treasury Management Strategy to cover: Borrowing Strategy, Investment Strategy and set Prudential Indicators together with borrowing limits for the next three years. In addition, the Council must approve an annual Minimum Revenue Provision Statement.

1.2 These strategies and statements have been prepared in accordance with the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes.

1.3 The Council's investment strategy remains to invest cash balances with highly rated bodies and external funds. Continued diversification of investment instrument and counterparty as a way of mitigating risk (while generating some form of return) remains key. There is also uncertainty around the implications of the so-called bank bail-in regulations which are being introduced on a phased basis in some EU countries (including UK) to prevent a future bail out of a financial institution by the relevant Government. Such implications may include what this will mean for bank credit ratings, the perceived (and possibly actual) increase in bank risk for depositors, the timing of any introduction as well as increased market concerns within and between jurisdictions.

1.4 The Borrowing Strategy is to finance the Council's capital programme, minimise revenue costs and maintain an under borrowed position.

1.5 The Council's medium term plan includes revenue budget provision to meet the capital financing costs based on the Capital Programme and the recommended option for the Minimum Revenue Provision.

2. RECOMMENDATIONS

2.1 That the Committee notes the paper and that Officers are seeking views from the Committee on the contents of the paper prior to submission to Cabinet in February and Council before 31 March.

2.2 That the Committee notes that the recommendations to Cabinet and Council will be as follows:

That the Council approves:

(i) The proposed Treasury Management Strategy, the Annual Investment Strategy and the Borrowing Strategy for 2015/16 (as set out in this paper);

(ii) The Minimum Revenue Provision proposal for 2015/16, as set out in section 8 and appendix 3;

(iii) The proposed Prudential Indicators, as set out in section 7; and

(iv) The Treasury Management Policy Statement as set out in Appendix 1.

3. REASONS FOR DECISIONS

3.1 The Council is required under the Local Government Act 2003 (as amended) and other regulations to approve an Annual Treasury Management Strategy to cover: Borrowing Strategy, Investment Strategy and set Prudential Indicators together with borrowing limits for the next three years. In addition, the Council must approve an annual Minimum Revenue Provision Statement.

4. BACKGROUND INFORMATION

4.1 The Treasury management service has two main functions, these are to:

(i) Ensure that cash flow is adequately planned with cash being available when required and that surplus monies are invested in low risk counterparties or financial instruments commensurate with the Council's treasury management strategy; and
(ii) Finance the Council's capital programme which requires longer term cash flow planning and borrowing assessments.

4.2 Both require robust financial management and rigorous cash flow modelling which feed into the Council's Medium Term Planning.

4.3 The Council's investment and borrowing policies are governed by the Local Government Act 2003 and the Secretary of State's Investment Code. These contain regulations backed up by various Codes of Practice. The Revised CIPFA Treasury Management Code of Practice 2009 and the Secretary of State's Investment Code, both require the s151 Officer to present an Annual Treasury Management Strategy ("TMS") which includes an Annual Investment Strategy, for the forthcoming year for approval by the full Council, before the beginning of each financial year. Further primary requirements of the Code are as follows:

(i) creation and maintenance of Treasury Management practices which set out the manner in which the Council will achieve its policies and objectives

(ii) receipt by the Council of a mid-year Treasury Review and an annual report in addition to the Treasury Management annual strategy

(iii) delegation by the Council of the scrutiny of the strategy and polices, for Westminster this is the Housing and General Purposes Body and for implementing, monitoring and administering treasury management decisions, which for Westminster is the City Treasurer.

4.4 While this paper sets out the Investment Strategy to be followed for the Council's cash balances, the Council also undertakes significant investment in other areas (e.g. Property, supporting start-up businesses in the borough) through a portion of its cash balances that occur outside the Treasury investment function per se. This is following detailed business case appraisal and member approval.

4.5 The City Council has also implemented the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 requiring Full Council to approve an Annual Statement of Minimum Revenue Provision which is the amount set aside from revenue for the repayment of debt principal relating to the General Fund only. This is set out in further detail in section eight below.

4.6 The revised CIPFA Prudential Code for Capital Finance in Local Authorities sets out indicators that are to be used to support capital expenditure plans and treasury management decisions. The Prudential and Treasury Indicators have to be set by the full Council when the budget is set and are monitored during the year.

4.7 This report deals with the following Treasury Management issues:

The Current Treasury Position
The Annual Investment Strategy
Capital and borrowing plans (including Treasury Limits, Prudential Indicators 2015/16 – 2017/18 and Related Matters)
Minimum Revenue Provision
Governance

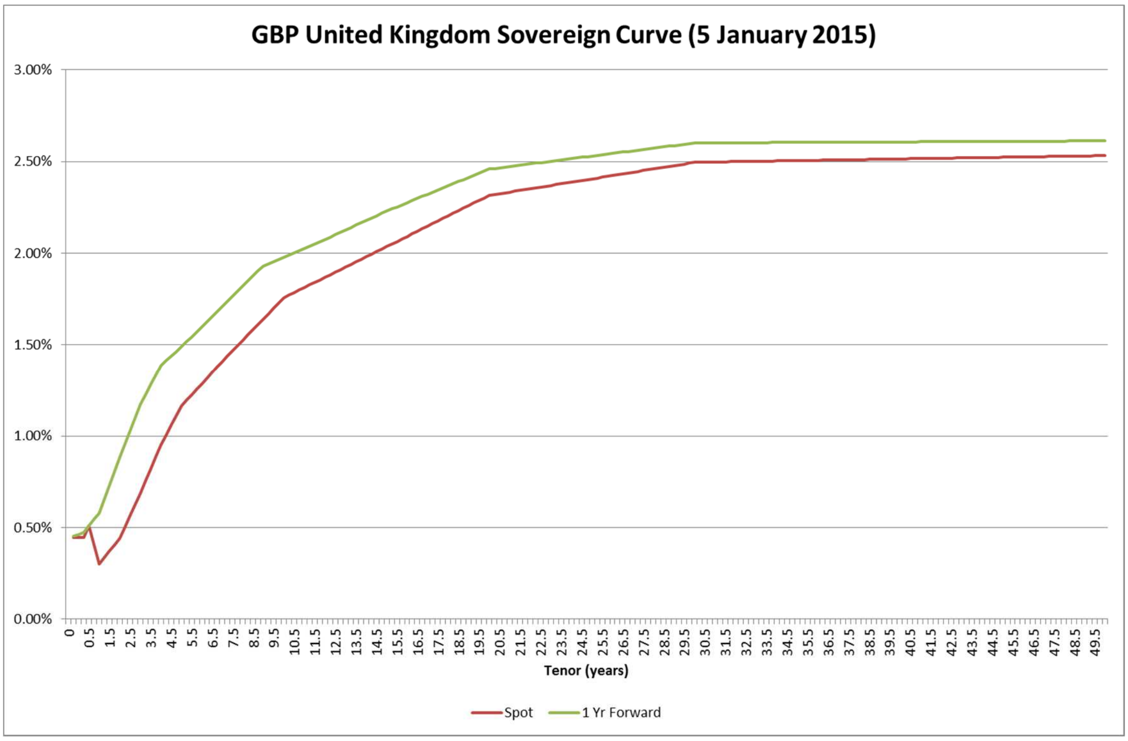
5. CURRENT TREASURY POSITION

5.1 Under the Council's Treasury Management Policy (produced in accordance with CIPFA's Code of Practice for Treasury Management in the Public Services), the Council is required to have a Treasury Management Strategy (TMS) approved by the full Council on at least an annual basis. The TMS sets out the framework under which the Council manages its treasury investment activities.

5.2 Over recent years, the Council has benefited from strong cash balances, and the returns due to the then prevailing interest rates. However the financial crisis and subsequent economic changes have had a marked impact on the financial environment (including lower interest rates) within which the Council operates.

5.3 At the end of period 9, (31 December 2014), the Council had total cash investments totalling £524 million. These are used to fund day to day service operations, support capital funding requirements and payments for services accrued but unpaid. Cash levels will decline over the remainder of the year due to the timing of the business rate collection cycle (limited collection during January to March).

5.4 The projections for interest rates remain low in the short term, with Bank of England overnight rate remaining at 0.5% for up to 12 months. However, market rates remain very volatile and are affected by Quantitative Easing (continuing, unchanging or reducing) and perceived safe-haven status of the UK, keeping rates low against risk of macro-economic issues (particularly in Europe) and inflation risk pushing rates higher. The graph below shows the current UK Gilt Curve, together with the one-year forward Gilt curve (i.e. current market expectations for the Gilt rates in 12 months' time). The current expectation is that Gilt rates will be slightly higher (up to 0.50%) for all tenors in a year's time, compared with today.



Source: Bloomberg data

5.5 The Council's treasury portfolio position at 31 March 2014, with forward projections is summarised below. Table 1 below shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

5.6 Table 1 shows the forecast position of gross borrowing as at 31/03/2015 at £328.3 million and an under borrowed position of £65.9 million. Council is asked to note the expected year end position.

Table 1 – Current & Forecast Treasury Portfolio

£m	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Gross Debt					
External Debt	319.3	306.4	328.3	396.1	461.22
Other Long Term Liabilities (OLTL)	23.05	21.66	19.94	17.79	15.12
Actual Gross Debt at 1 April	342.60	306.31	348.24	413.89	476.34
Expected changes in Debt	(34.60)	10.82	7.93	80.34	98.90
Expected Change in OLTL	(1.39)	(1.72)	(2.14)	(2.67)	(3.35)
Actual Gross Debt at 31 March	306.36	328.3	396.1	461.22	572.99
Capital Financing Requirement	383.39	394.21	402.13	482.47	581.38
(Under) / over borrowing	**(77.03)**	**(78.80)**	**(48.10)**	**9.09**	**(9.49)**

5.7 Table 1 above shows the Council will need to take out significant borrowings during 2015/16 to 2018/19 if the capital programme spends in accordance with the anticipated profile.

5.8 There are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. It is clear from the table above that the Council's gross borrowing position is well within these limits.

6. ANNUAL INVESTMENT STRATEGY

6.1 This section sets out the Council's annual investment strategy for 2015/16 and notes any proposed changes from the 2014/15 Treasury Management Strategy, the table below summarises the maximum amounts and tenors of investments that the Council can hold. The table also shows the maximum proposed limits that officers can work within

Table 2 – Maximum Amounts and Tenors of Investments

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment	Treasury Management Strategy 2014/15
DMO Deposits	UK Government Rating	Unlimited	6 months	No change
UK Government (Gilts / T-Bills / Repos)	UK Government Rating	Unlimited	Unlimited	No change
Supra–national Banks	AA+ / Aa1 / AA+	£200m	5 years	£100m / 3 years
European Agencies	AA+ / Aa1 / AA+	£200m	5 years	£100m / 3 years
Network Rail	UK Government Rating	Unlimited	Oct 2052	No change
TfL	AA-/Aa3/AA-	£100m	5 years	3 years
GLA	NA	£100m	5 years	3 years
UK Local Authorities	NA	£50m per Local Authority, £100m in aggregate	3 years	No change
GBP denominated Commercial Paper issued by UK and European[1] corporates	A-1 / P-1 / F-1	£40m per name, £200m in aggregate	Six months	£20m per name / £100m in aggregate. Extended for 15/16 to cover European[1] corporates
Money Market Funds MMF	AAA / Aaa / AAA be AAA by at least two of the main credit agencies	£70m per fund manager, £300m in aggregate	Three day notice	£50m per fund, £200m in aggregate
Enhanced Money Funds	AAA / Aaa / AAA by at least one of the main credit agencies	£25m per fund manager, £75m in aggregate	Up to seven day notice	£50m in aggregate
Covered Bonds	AA+ / Aa1 / AA+ of the bond issue; investment grade of underlying issuer	£100 million	5 years	NEW

[1] Subject to paragraph 6.15 below.

Institution Type	Minimum Credit Rating Required (S&P / Moodys / Fitch)	Maximum Individual Counterparty Investment limit (£m)	Maximum tenor of deposit / investment	Treasury Management Strategy 2014/15
UK Bank (deposit or Certificates of Deposit)	AA- / Aa3 / AA- and above (or UK Government ownership of greater than 25%), subject to minimum ST ratings	£75m	5 years	3 years; CD a new asset class
UK Bank (deposit or Certificates of Deposit)	A- / A3 / A- and above, subject to minimum ST ratings	£50m	3 years	Six months; CD a new asset class
Non-UK Bank (deposit or Certificates of Deposit)	AA- / Aa2 / AA- and above, subject to minimum ST ratings	£50m	5 years	One year; CD a new asset class
Non-UK Bank (deposit or Certificates of Deposit)	A / A2 / A and above, subject to minimum ST ratings	£35m	3 years	Six months; CD a new asset class

6.2 The remainder of this section covers the following in further detail:

Current investment types
Changes for the 2015/16 Treasury Management Strategy
- Commercial paper to cover European corporates
- Covered bonds
- Certificates of deposit

Proposed changes to investment limits and tenors
Non-specified investments
Country of domicile
External managers

<u>Current Investment Types</u>

6.3 As per the 2014/15 Treasury Management Strategy, it is proposed that for 2015/16 the Council can continue to invest in financial institutions, external funds and certain capital market instruments as set out below. All investments would be in Sterling. The investment types listed below are as per the current TMS:

(i) investment with the Debt Management Office with no financial limit (UK Government guaranteed)
(ii) investment in financial institutions of a minimum credit rating, with the parent company domiciled only in jurisdictions as per paragraphs 6.15-6.17 below;
(iii) investment in UK Treasury Bills (T-Bills) and Gilts (conventional and indexed-linked) both fixed and floating rate;
(iv) investments in UK Government repurchase agreements (“Repos” and “Reverse Repos”);
(v) investments in UK local authorities;
(vi) investment in close to maturity AAA-rated corporate bonds and commercial paper backed by UK Government guarantees (fixed and floating rate);

(vii) investment in supra-national AAA-rated issuer bonds and commercial paper (fixed and floating rate);
(viii) investment in AAA-rated Sterling Money Market Funds and longer term funds; and
(ix) investment in commercial paper ("CP") of UK domiciled entities with minimum short term credit rating of A1/P-1/F-1.

6.4 For 2015/16, it is proposed to remain with these investment criteria as above, as well as add some new investments set out in paragraph 6.5 below. In determining whether to place deposits with any institution or fund, investments will remain within the limits set out above, but the Director of Corporate Finance and Investment will take into account the following relevant matters when proposing how much to invest within the limit set out above:

(i) the financial position and jurisdiction of the institution;
(ii) the market pricing of credit default swaps[2] for the institution;
(iii) any implicit or explicit Government support for the institution;
(iv) Standard & Poor's, Moody's and Fitch's short and long term credit ratings; and
(v) core Tier 1 capital ratios[3].

Changes for the 2015/16 Treasury Management Strategy

6.5 Officers are proposing various changes to the 2015/16 Treasury Strategy, in part to continue to reduce reliance on the Debt Management Office and to provide some flexibility for better investment returns, within the structure of a cautious investment outlook. Continued diversification of investment instrument and counterparty as a way of mitigating risk (while generating some form of return) remains key. There is also uncertainty around the implications of the so-called bank bail-in regulations which are being introduced on a phased basis in some EU countries (including UK) to prevent a future bail out of a financial institution by the relevant Government. Such implications may include what this will mean for bank credit ratings, the perceived (and possibly actual) increase in bank risk for depositors, the timing of any introduction as well as increased market concerns within and between jurisdictions.

6.6 As a result of the developments in the paragraph above, the proposals for 2015/16, while building on the Treasury Management Strategy for 2014/15, make a recommendation for the use of Commercial Paper (CP) for European corporates, Covered Bonds and Certificates of Deposit (CDs) as well as adjusting limits and tenors for existing investment classes. The tenors and minimum credit ratings for the various investment classes are set out in the table 2 above.

[2] Credit Default Swaps (CDS) are tradeable instruments where the buyer receives a pay-out from the seller if the party to whom the CDS refers (often a financial institution) has a "credit event" (e.g. default, bankruptcy, etc.). The price of the CDS gives an indication to the market's view of likelihood – the higher the price the more likely the credit event.

[3] The Tier 1 capital ratio is the ratio of a bank's core equity capital to its total risk-weighted assets (RWA). Risk-weighted assets are the total of all assets held by the bank weighted by credit risk according to a formula determined by the Regulator (usually the country's central bank). Most central banks follow the Basel Committee on Banking Supervision (BCBS) guidelines in setting formulae for asset risk weights.
The Core Tier 1 ratios for the four UK banks that WCC uses are: Barclays: 10.2%, HSBC: 11.2%, Lloyds: 12.0% and RBS: 10.8%.

Commercial Paper issued by European corporates

6.7 While the Council has invested in CP from UK entities (mainly Network Rail and TfL), there are large globally recognised European companies that issue Sterling CP. The company would need to be domiciled in European countries as set out in paragraphs 6.15 – 6.17. Given the current investment return, low risk and further diversification (as well as a continued Sterling investment) such an investment fits within the Council's approach to investment in recent years. As noted elsewhere in this paper, investment in commercial paper would require minimum short term credit rating of A1/P-1/F-1.

Covered Bonds

6.8 Covered bonds are debt instruments issued by a financial institution, but where security has been granted over a pool of underlying assets (e.g. a pool of mortgage loans or public-sector debt) to which investors have a preferential claim in the event of default. The covered bond issue would be rated by the rating agencies, and while the issuer would be allowed to "swap" some of the underlying collateral, it is up to an independent custodian / agent to validate that what is being taken out of the pool is of no worse status than that being switched in. The issuance of covered bonds enables financial institutions to obtain lower funding in order grant mortgage loans for housing and non-residential property as well as to finance public debt.

Certificates of deposit

6.9 Financial institutions as well as offering loans, also borrow through the issuance of Certificates of Deposit (CD). These are tradeable instruments where the issuer borrows at a set rate for an agreed length of time, before repaying the principal at maturity. CDs tend to have shorter length tenors than bonds, and enable an investor to manage more actively any credit / counterparty exposure, rather than waiting for a fixed term deposit to mature.

Proposed changes to investment limits and tenors

6.10 Given investments to date, the shape of the current yield curve, the likely low level of interest rates for the immediate future and the opportunities for investment, it is proposed that limits and tenors of investment are extended for many investment types – both in tenor and / or investment limit.

6.11 Such changes would allow the Council to invest in longer maturities and take advantage in any yield pick-up as well as reducing reliance on the banking institutions – at the moment, there is uncertainty on the timing and impact of any introduction of bail-in regulations. It would be prudent for the Council to be able to remove direct reliance on such an asset class without impacting return too severely.

6.12 The graph in paragraph 5.4 above shows a steep current and one-year forward yield curve, and that higher returns for tenors up to five years (for a core level of cash) would provide greater returns rather than a shorter investment. Given the predicted rise in interest rates however, the Council while wanting to take advantage of higher rates for longer duration investments will also want to benefit from a rise in rates when they occur rather than locked in to then lower yielding investments.

Specified and Non-specified investments

6.13 Under section 15(1) of the Local Government Act 2003, restrictions are placed on Local Authorities around the use of specified and non-specified investments. A specified investment is defined as an investment which satisfies all of the conditions below:

(i) The investment and any associated cash flows are denominated in sterling;
(ii) The investment has a maximum maturity of one year
(iii) The investment is not defined as capital expenditure; and
(iv) The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

6.14 A non-specified investment is any investment that does not meet all the conditions above. The only likely non-specified investment that the Council may make is for any investment greater than one year as set out in the table above. For such an investment, a proposal will be made by the Director of Corporate Finance and Investments, to the s151 Officer after taking into account cash flow requirements, the outlook for short to medium term interest rates and the proposed investment counterparty.

Country of Domicile

6.15 The current TMS allows deposits / investments with financial entities domiciled in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK and USA. This list will remain for 2015/16.

6.16 For Commercial Paper and bonds issued by supra-nationals and European agencies, the entities must be domiciled in countries listed above.

6.17 For Commercial Paper for UK and European corporates, the entities must be domiciled in the EU countries named in paragraph 6.15 above.

External managers

6.18 Apart from the various money market and enhanced money funds, where invested amounts are managed directly by officers, approximately £10 million was placed on longer-term (greater than one year) deposits through Tradition (an advisor / broker used at the time), an intermediary between the banks and potential depositors.

6.19 All other investments are now managed directly by the treasury team on behalf of the City Treasurer who may make use of market intermediaries such as brokers or other advisors as necessary.

7. CAPITAL AND BORROWING PLANS (including Treasury Limits, Prudential Indicators 2015/16 – 2017/18 and Related Matters)

Capital Plans

7.1 The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans. These indicators as per the Capital Programme include previous years' actual expenditure, forecast expenditure for this current year and estimates for the next three year period.

7.2 Linked to the above the Council is continuously reviewing the capital programme and its financing in accordance with new and emerging priorities and the current severe financial climate. Both to ensure that it maintains prudent financing of the programme combined with delivering a programme which is priority driven and which meets the needs of the City

Capital Expenditure Estimates

7.3 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The Council is asked to approve the capital expenditure forecasts which align to the capital strategy for 2015/16 onwards as set out in the table below:

Table 3 – Capital Expenditure Estimates

£m	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA	30.02	68.00	93.39	83.29	60.30
General Fund	74.83	127.91	184.23	114.64	103.94
Total	**104.85**	**195.90**	**277.62**	**197.76**	**164.24**

7.4 Table 4 below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing). The borrowing need for 2015/16 is £98.7m. This will however change if there is a change to the spending profile of the capital programme.

Table 4 – Funding of the Capital Programme

£m	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capita Receipts	3.79	10.51	39.77	50.61	33.64
Capital Grants	51.83	66.88	87.84	20.82	1.72
Revenue	26.58	54.10	51.32	26.48	26.66
Total	**82.20**	**131.49**	**178.93**	**97.91**	**62.02**
Net Financing Need for the Year	**22.65**	**64.73**	**98.69**	**99.84**	**102.22**

The Council's Borrowing Need (the Capital Financing Requirement)

7.5 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

7.6 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

7.7 The CFR includes any other long term liabilities (e.g. Private Finance Initiative (PFI) schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to borrow separately for these schemes. The Council currently has £19.93m of such schemes within the CFR, decreasing to £17.79m in 2015/16. The Council is requested to approve the CFR projections.

Table 5 – Capital Financing Requirement (CFR)

£m	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
HRA	276.12	275.87	278.17	284.37	284.38
General Fund	107.27	118.34	123.96	198.10	297.00
Total	**383.39**	**394.21**	**402.13**	**482.47**	**581.38**
Movement in CFR represented by					
Net movement in financing need for the year	12.88	10.82	7.93	80.34	98.90
Additions (net)	22.65	64.73	98.69	99.84	102.22
Less MRP	(9.77)	(53.91)	(90.77)	(19.50)	(3.32)
Movement in CFR	**12.88**	**10.82**	**7.93**	**80.34**	**98.90**

<u>Affordability Prudential Indicators</u>

7.8 The previous sections cover the overall capital programme and control of borrowing prudential indicators, but within this framework, prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

7.9 The Council is asked to approve the following indicators:

a) Ratio of financing costs to net revenue stream: This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this report.

Table 6 – Ratio of net financing cost to net revenue stream

£m	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Revenue Stream					
HRA	103.16	113.37	118.10	121.44	125.99
General Fund	240.59	225.29	200.60	178.10	166.60
TOTAL	**343.75**	**338.66**	**318.70**	**299.54**	**292.59**
Financing Costs					
HRA	12.83	12.97	13.73	14.77	14.77
General Fund	6.29	7.24	7.99	8.37	13.37
TOTAL	**19.12**	**20.21**	**21.72**	**23.14**	**28.14**
Ratio (%)					
HRA	12.44	11.44	11.63	12.16	11.72
General Fund	2.62	3.22	4.49	4.7	8.03
Combined Ratio	**5.57**	**5.97**	**6.82**	**7.73**	**9.62**

b) Incremental impact of new capital investment decisions on council tax and housing rents: Table 7 shows the effect of the totality of the Council's capital plans currently being considered and shows the impact on Council Tax that would result, holding all other things constant. This indicator should reflect the revenue impact of capital schemes.

Table 7 – Incremental impact of new capital investment decisions on Council Tax

£	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
For Band D Council Tax	Base	7.83	13.95	10.94	48.88
For average weekly Housing Rents	Nil	-0.07	-0.04	-	0.02

7.10 The above calculation is based on Band D equivalent properties, using the approved tax base for 2015/16 of 121,891 properties.

Borrowing

7.11 The capital expenditure plans set out in the Council Tax Report provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Treasury Limits for 2015/16 to 2017/18

7.12 The "Prudential Code" as set out by CIPFA (Local Authority Capital Financing Regulations 2003 reg. (2)) requires the Council to determine its authorised limit and operational boundary for external debt for the next three years.

Operational Boundary

7.13 The proposed operational boundary for 2014/15 to 2016/17 is set out in Table 8 below. The boundary reflects the maximum anticipated level of external debt consistent with budgets and forecast cash flows, and the Capital Financing Requirement. This boundary will be used as a management tool for on-going monitoring of external debt, and may be breached temporarily due to unusual cash flow movements. Such an event would be reported to the Cabinet Member. However a sustained or regular trend above the operational boundary should trigger a review of both the operational boundary and the authorised limit.

Table 8 – Operational Boundary

£m	**2013/14 Actual**	**2014/15 Forecast**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Borrowing	283.3	466	496	526	556
Long Term Liabilities	18.0	24	24	24	24
Total	**301.3**	**490**	**520**	**550**	**580**

Authorised Limit

7.14 A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

7.15 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Councils' plans, or those of a specific Council, although this power has not yet been exercised.

7.16 Council is asked to approve the following authorised limit:

Table 9 – Authorised Limit

£k	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	283.3	486	516	546	576
Long Term Liabilities	18.0	24	24	24	24
Total	**301.3**	**510**	**540**	**570**	**600**

Public Sector Lending Agencies

7.17 The Public Works Loan Board (PWLB) lending rates are based on the UK Government borrowing rate, and have a margin of 1% over those rates. The graph in paragraph 5.4 shows the current Gilt rates and one-year forward rates. Thus PWLB rates are expected to gradually increase during the year. Rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt. There is likely to be little difference between 25 year and 50 year rates thus loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the difference between the PWLB new borrowing and early repayment rates is considerably less.

7.18 Technically, the PWLB is responsible to its commissioners which are notionally considered to be arms-length from the Debt management Office and HM Treasury. However, the government has published legislative proposals to abolish the PWLB commissioners and transfer their functions to another body

7.19 Ministers have tabled an amendment to the Infrastructure Bill which would allow them to make an order under the Public Bodies Act 2011 to enact any change. HM Treasury have said that the reform was restricted to governance of the PWLB and would not affect the range of products available to councils.

7.20 The Local Government Association has also been instrumental in establishing a Municipal Bond Agency, of which the Council is a founding shareholder. The Agency plans lend to local authorities with funds raised in the capital markets and from other sources. The agency is in the early stages of being set up, and has not yet made any loans or borrowings.

Borrowing Strategy

7.21 The factors that influence the 2015/16 strategy are:

- The increasing Capital Financing Requirement as per Table 4

- The interest rate forecasts
- Aiming to minimise revenue costs to minimise the impact on Council Tax.
- The impact of the Council's Investment Programme

7.22 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council'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, however as interest rates are low, consideration will be given to taking advantage of this by securing fixed rate funding and reduce the under borrowed position.

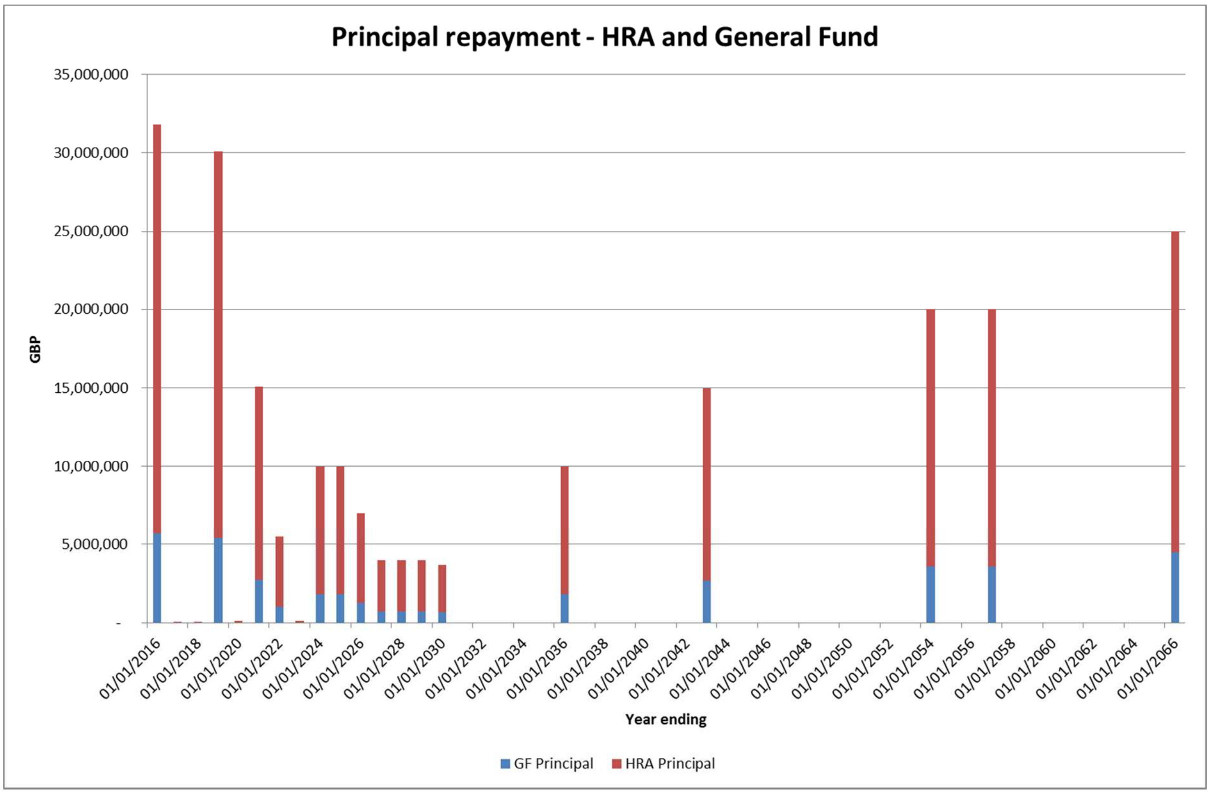
7.23 Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Treasury Management team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

7.24 If it were considered that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

7.25 If it were considered that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

7.26 The gross borrowing requirement in Tables 4 and 5 above show, based on current estimates, that the Council will need to take out a significant amount of new borrowings from 2016/17, to support the capital programme. Any new borrowing taken out will be completed with regard to the limits, indicators and interest rate forecasts set out above.

7.27 The chart below shows the principal repayment profile for the Council's current borrowings. Based on current interest rates it is not anticipated that these loans will require refinancing.



7.28 The Council has £70 million of LOBO (Lender Option Borrower Option) debt, none of which has final maturity in the near future. Were the lender to exercise their option, Officers will consider accepting the new rate of interest or repaying (with no penalty). Repayment of the LOBO may then require re-financing at the prevailing market rates.

7.29 The General Fund has not incurred any new borrowing in the current financial year and has repaid five loans totalling £1.4 million. Given the prevailing low level of interest rates, Officers may consider voluntary early repayment of borrowing as a way of making more efficient use funds in the short term.

7.30 The General Fund may increase external borrowing by up to £150 million to assist in the financing of temporary accommodation provision. Any increase in external borrowing will be within the Council's Authorised Limit as set out in this paper.

7.31 Members will recall that, from 2017/18, Service Areas will be charged in full for the revenue consequences incurred from borrowing to fund their capital expenditure. This will ensure that the cost of spending decisions are taken into account when considering all programmes of work and will make sure the programme is fully financed on an on-going basis. Based on the current projections, it is estimated that the annual cost of borrowing will be £17.7m by 2020.

Treasury Management Prudential Indicators – Limits on Activity

7.32 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Table 10 – Limits on Interest rate exposures

	2014/15	2015/16	2016/17
Borrowing			
Fixed interest rate exposures	100%	100%	100%
Variable interest rate exposures	50%	50%	50%
Investments			
Fixed interest rate exposures	50%	50%	50%
Variable interest rate exposures	100%	100%	100%

7.33 Table 11 below sets out the proposed upper and lower limits on maturity structure of fixed rate debt, for 2015/16. The maturity structure guidance of LOBO's (Lender Option Borrower Option) changed in 2011. As per the Revised Prudential Code 2011, the call date is now deemed to be the maturity date. LOBO's are classed as fixed rate debt until the call date. Within the next 12 months 2015/16 up to 80% of LOBO debt will reach its call date, however it is not anticipated that these loans will be called by the institutions and require refinancing.

Table 11 – Upper and lower limits on maturity structure of fixed rate debt

(%)	Upper limit	Lower limit
Under 12 months	40	0
1-2 years	35	0
2-5 years	35	0
5-10 years	50	0
10 years and over	100	35

7.34 Table 12 below sets out the limits of funds that may be invested for more than one year. As at 31 December 2014, the Council had approximately £25 million as an investment for more than one year (in a UK Gilt). Given the proposed strategy, it is likely that the amount on deposit for more than one year will increase in 2015/16.

Table 12 – Limit on Investments for periods over 364 days

£ million	2013/14 (actual)	2014/15	2015/16	2016/17	2017/18
Total principal sums invested for more than 364 days	34.6	300	300	300	300

Policy on Borrowing in Advance of Need

7.35 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

7.36 Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

7.37 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

7.38 The reasons for any rescheduling to take place will include:

the generation of cash savings and / or discounted cash flow savings;

helping to fulfil the treasury strategy;

enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

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

8. MINIMUM REVENUE PROVISION

8.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (the Regulations) require the Council to approve a Minimum Revenue Provision (MRP) Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits.

8.2 It is proposed to continue with the MRP Policy as put in place last year where provision uses the Regulatory method for all borrowing prior to 1 April 2008 and the Asset Life method, for borrowing under the Prudential Code from 1st April 2008.

8.3 The Asset Life method is calculated using an annual charge, either in equal instalments over the life of the asset, or using an annuity method. A benefit of this alternative is the MRP becomes chargeable either in the year following capital expenditure or in the year the asset comes into service, making some complex capital expenditure schemes more affordable.

8.4 Under the Asset Life Method the Council must make an assessment of the life of the asset to which the capital expenditure financed by debt relates. The majority of the Council's capital expenditure relates to infrastructure and buildings assets. It is proposed that a life of 30 years is used for infrastructure assets, 40 years for buildings assets with potential to increase the term for specific assets if the underlying facts lead to a positive rationale. This assessment is based on information contained within the Transportation Asset Management Plan (for infrastructure assets) and a reasonably prudent estimate of the average life of building structures within our property portfolio

8.5 There is no statutory requirement to make MRP in respect of HRA borrowing.

8.6 The s151 Officer therefore recommends the adoption of the methods listed above for calculating Minimum Revenue Provision for 2015/16. The Minimum Revenue Provision Policy Statement 2015/16 is included in Appendix 3.

9. GOVERNANCE

9.1 The revised CIPFA Treasury Management Code requires the Council to outline a scheme of delegation thereby delegating the role of scrutiny of treasury management strategy and policy to a specific named body. In this way treasury management performance and policy setting will be subject to proper scrutiny. The Code also requires that members are provided with adequate skills and training to effectively discharge this function.

9.2 The role of the s151 officer has the authority pursuant to Section 101 of the Local Government Act 1972 and by the Executive under Section 15 of the Local Government Act 2000:

9.3 The s151 Officer may authorise officers to exercise on him behalf, functions delegated to him. Any decisions taken under this authority shall remain the responsibility of the s151 Officer and must be taken in his name and he shall remain accountable for such decisions.

9.4 The s151 Officer has full delegated powers from the Council and is responsible for the following activities:

(i) Investment management arrangements and strategy;
(ii) Borrowing and debt strategy;
(iii) Monitoring investment activity and performance;
(iv) Overseeing administrative activities;
(v) Ensuring compliance with relevant laws and regulations;
(vi) Provision of guidance to officers and members in exercising delegated powers.

<u>Monitoring and Reporting</u>

9.5 The treasury management activities during the year will be included in monitoring reports to the Housing, Finance & Customer Services Policy and Scrutiny Committee.

9.6 The Council's Treasury Management Strategy will be approved annually by full Council and there will also be a mid-year report.

9.7 The aim of these reporting arrangements is to ensure that those with responsibility for treasury management appreciate fully the implications of treasury management policies and activities and those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting. The Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code:

Area of Responsibility	**Council / Committee / Officer**	**Frequency**
Treasury Management Strategy / MRP Policy	Full Council	Annually, at a meeting before the start of the financial year.
Scrutiny of Treasury Management Strategy	Housing, Finance & Customer Services Policy and Scrutiny Committee	Annually
Treasury Management Strategy – mid-year report	Housing, Finance & Customer Services Policy and Scrutiny Committee	Annually after first half of the financial year
Treasury Management Strategy / MRP Policy – updates/revisions at other times	1. Housing, Finance & Customer Services Policy and Scrutiny Committee; and then 2. Full Council	As and when required
Annual Treasury Outturn Report	1. Housing, Finance & Customer Services Policy and Scrutiny Committee; and then 2. Full Council	Annually, by 30 September following year-end
Treasury Management Practices	City Treasurer	Quarterly
Treasury Management Monitoring Reports	Cabinet Member for Finance and City Treasurer	Monthly

10. BACKGROUND AND FINANCIAL AND LEGAL IMPLICATIONS

10.1 The Local Government Act 2003 requires 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. These are contained within this report.

10.2 The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments. The Annual Investment Strategy must have regard to guidance issued by CLG and must be agreed by the full Council.

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

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11. BACKGROUND PAPERS

Treasury Management Strategy 2014/15 (Approved by Council March 2014)

1. Revised CIPFA Treasury Management Code of Practice 2009
2. Local Authorities (Capital Finance and Accounting) (England) Regulation 2008
3. Section 3 Local Government Act 2003
4. CLG Guidance on Local Government Investments – March 2004

APPENDIX 1

THE TREASURY MANAGEMENT POLICY STATEMENT

INTRODUCTION

The CIPFA recommendations contained in the Code of Practice and Cross-Sectoral Guidance Notes issued as a revised version in 2009 for Treasury Management in the Public Services require that each Local Authority has a Treasury Management Policy Statement that is approved by the Full Council.

The City of Westminster Council defines its treasury management activities as:

> *"The management of the organisation's 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".*

The Council regards the prime policy objective of its investment activities as to practice safety and liquidity and to avoid exposing public funds to unnecessary or unquantified risk. The Council views the pursuit of optimum performance from the investment of legitimate surplus funds as a secondary objective.

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 risk implications for the organisation.

The Council also acknowledges 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 best value in treasury management, and to employing suitable performance measurement techniques, always in the context of effective risk management.

BACKGROUND

The Council revenues from its operations, capital receipts together with certain taxes and Government grants. Due to the timing of income and expenditure cashflows, the Council's cash flows generate balances, which are available for investment. This policy sets out the parameters within which Officers will operate to manage these cash flows in accordance with the Local Government controls applicable from time to time.

SCOPE

This policy will be operated through the s151 Officer (delegated to the Director of Corporate Finance and Investment) and will be applied to all parts of Westminster Council. The Council and its subsidiary companies will have no authority to invest or borrow, or enter into credit arrangements, without the written consent of the s151 Officer, after taking advice from the Director of Corporate Finance and Investment.

RESPONSIBLE OFFICERS

The s151 officer is responsible for advising the Council on investments, borrowing, and capital financing and also for the establishment and operation of banking arrangements necessary for the Council's business, as well as ensuring the execution of this policy is consistent with legislation. On an operational basis this will be discharged through the Director of Corporate Finance and Investment.

APPENDIX 2

MINIMUM REVENUE PROVISION POLICY STATEMENT 2015/16

The Council implemented the revised Minimum Revenue Provision (MRP) guidance in 2008/09, and assess its MRP for 2008/09 onwards 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.

The major proportion of the MRP for 2012/13 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 (Regulatory Method) of the guidance.

The s151 Officer therefore determines to use option 1 for pre-2008 debt. The determination depends on the most appropriate method of making a prudent provision, after having had regard to the guidance.

Certain expenditure reflected within the debt liability at since 2008 will, under delegated powers, be subject to MRP under option 3 (Asset Life Method), which will be 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.

The estimated life of assets will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. 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.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure.

The Council reserves the right to revisit its MRP policy during the year as per statutory instrument 414 (2008).