**Appendix 3**
**to Item No B2**

# ANNUAL TREASURY MANAGEMENT STRATEGY STATEMENT 2013/14

## Introduction

1. **Policy Statement** - The Authority 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 these activities; and the pursuit of optimum performance consistent with those risks'.

2. The Authority regards the successful identification, monitoring and control of risk to be the main 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.

3. This Authority 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 value for money in treasury management and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

4. This strategy complies with the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the TM Code) and Guidance on Local Government Investments, issued by the Secretary of State for Communities and Local Government under section 15(1)(a) of the Local Government Act 2003 ("the Guidance"). Day to day treasury activity is carried out under a service level agreement by the Kent County Council Treasury and Investments Section. Specific decisions on the timing and amount of any borrowing will be made by the Director of Finance and Corporate Services and the Assistant Director of Finance, in line with the agreed strategy.

## Capital Plans and Prudential Indicators 2013/14 to 2015/16

5. The Authority's plan for capital expenditure is one of the key drivers for treasury management activity. The plan is reflected in the prudential indicators that are set by the Authority as part of the strategy. These indicators are designed to ensure that the plan is affordable in the short term and sustainable in the long term. A summary containing all of the indicators is given at Annex A.

6. **Capital expenditure** - This can be paid for directly from the revenue budget, capital receipts and capital grants, or from borrowing (external or internal). The Authority's capital plan, and the revenue and capital resources being used to finance the plan, are shown in **Table 1** below. The difference between expenditure and cash resources results in an increase in the net financing need, i.e. requirement to borrow.

| **Table 1** | **Capital Expenditure** | | | |
|---|---|---|---|---|
| | **2012/13 Forecast Outturn £'000** | **2013/14 Estimate £'000** | **2014/15 Estimate £'000** | **2015/16 Estimate £'000** |
| **Total Capital Expenditure** | **9,465** | **12,484** | **16,857** | **9,805** |
| **Financed By:** | | | | |
| Capital Receipts | 778 | 1,300 | 700 | 500 |
| Revenue Contribution | 3,207 | 6,957 | 7,229 | 2,026 |
| Capital Grants | 2,268 | 2,394 | 2,019 | 500 |
| **Net Financing Need (Borrowing) for the Year** | **3,212** | **1,833** | **6,909** | **6,779** |

7. **The Capital Financing Requirement (CFR)** – The CFR represents the amount of historic capital expenditure which has not been paid for from revenue, capital receipts or capital grants. It is a measure of the Authority's underlying need to borrow. The CFR projections are shown in **Table 2** below.

| **Table 2** | **Capital Financing Requirement (CFR)** | | | |
|---|---|---|---|---|
| | **2012/13 Forecast Outturn £'000** | **2013/14 Estimate £'000** | **2014/15 Estimate £'000** | **2015/16 Estimate £'000** |
| Opening CFR | 8,308 | 10,551 | 11,415 | 17,321 |
| Movement in CFR | 2,243 | 864 | 5,906 | 5,592 |
| **Closing CFR** | **10,551** | **11,415** | **17,321** | **22,913** |
| **Movement in CFR represented by:** | | | | |
| **Net Financing Need (Borrowing) for the Year** | 3,212 | 1,833 | 6,909 | 6,779 |
| Less: Provision for Principal Debt Repayment | (969) | (969) | (1,003) | (1,187) |
| **Movement in CFR** | **2,243** | **864** | **5,906** | **5,592** |

8. **Minimum Revenue Provision (MRP) Policy Statement** - For supported borrowing the Authority is required to make an annual charge to revenue for the repayment of debt based on a 25-year repayment period. For prudential borrowing the amount charged to revenue for debt repayment must be linked to the life of the assets purchased. In both cases this charge is called the Minimum Revenue Provision (MRP). Additional amounts may be set aside to repay any debt liability earlier than originally planned. Since 2006/07, the Authority has adopted a policy to align the revenue provision for debt repayment for supported borrowing more closely to the life of assets purchased. As the Authority's borrowing relates almost entirely to the purchase of vehicles in the 15-year vehicle replacement programme, debt is currently being repaid over a 15-year period.

9. For all unsupported borrowing arising after 1 April 2008, the MRP policy will be to use a method of providing for repayment of debt that reflects the life of the asset acquired, which will be either the:

(a) **Asset Life Method** - Minimum Revenue Provision (MRP) will be based on the estimated life of the assets, in accordance with current regulations (this option to be applied for any expenditure capitalised under a Capitalisation Directive); and/or the

(b) **Depreciation Method** - MRP will follow standard depreciation accounting procedures.

10. For prudential borrowing there is no requirement for amounts to be set aside from revenue for principal debt repayment until the asset is completed and brought into use.

11. **Estimates of the Ratio of Financing Costs to Net Revenue Stream** - This indicator provides an indication of the impact of the capital plans on the Authority's overall finances by identifying the trend in net borrowing costs (borrowing costs net of investment income). **Table 3** below provides estimates of the ratio of financing costs to net revenue stream for the current and future years.

| **Table 3** | **Ratio of Financing Costs to Net Revenue Stream** | | | |
|---|---|---|---|---|
| | **2012/13** | **2013/14** | **2014/15** | **2015/16** |
| | **Forecast Outturn** | **Estimate** | **Estimate** | **Estimate** |
| | **£'000** | **£'000** | **£'000** | **£'000** |
| **Net Revenue Budget** | 73,418 | 70,936 | 68,905 | 66,338 |
| **Net Borrowing Costs** | 1,243 | 1,161 | 1,354 | 1,827 |
| **Total Ratio** | 1.69% | 1.63% | 1.96% | 2.75% |

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12. **Estimates of the Incremental Impact of Capital Investment Decisions on Council Tax** - A key measure of affordability is the incremental impact of capital spending decisions on council tax. **Table 4** below shows the impact of new investment decisions contained within the capital plan for 2013-16 on Band D council tax.

| **Table 4** | **Impact on Band D** | | |
|---|---|---|---|
| | **2013/14 Estimate** | **2014/15 Estimate** | **2015/16 Estimate** |
| Impact on Council Tax Band D | £0.02 | £0.10 | £0.71 |

**The Treasury Management Strategy**

13. The plans for capital expenditure are set out in the previous paragraphs. The treasury management function ensures that the Authority has sufficient cash to meet this expenditure. This involves the management of the organisation's cash flow and the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual Investment Strategy.

14. **The Current Debt Portfolio** - The Authority's current debt portfolio position as at 31 March 2013 with projections for the next three years is detailed in **Table 5** below.

| **Table 5** | **Current Debt Portfolio Position** | | | |
|---|---|---|---|---|
| | **2012/13 Forecast £'000** | **2013/14 Estimate £'000** | **2014/15 Estimate £'000** | **2015/16 Estimate £'000** |
| **Borrowing as at 1 April** | **6,540** | **6,015** | **7,323** | **14,540** |
| New Borrowing less Provision for Debt Repayment | 0 | 1,833 | 8,947 | 5,592 |
| Loans Repaid | -525 | -525 | -1,730 | -425 |
| **Borrowing as at 31 March** | **6,015** | **7,323** | **14,540** | **19,707** |
| **CFR** | **10,551** | **11,415** | **17,321** | **22,913** |
| **Investments as at 31 March** | **-30,502** | **-25,140** | **-18,386** | **-16,791** |
| **Net Borrowing/(Investments)** | **-24,487** | **-17,817** | **-3,846** | **2,916** |

15. The Authority's gross debt should not, except in the short term, exceed the total of the capital financing requirement for the current year and the next two financial years. This allows the Authority the flexibility to borrow for future years whilst ensuring that borrowing is not undertaken for revenue purposes. The Authority does not envisage any difficulty in complying with this indicator. The level of actual borrowing and the CFR will often be different for a combination of reasons. It could be due to timing differences between amounts set aside for the repayment of debt and the actual timing of loan repayments, but it could also be due to a decision to defer the borrowing relating to capital expenditure that has already been incurred. The table above assumes that £4,536k of borrowing currently carried against internal balances may be externalised but this and other new borrowing may again be deferred to reduce counterparty risk and reduce interest costs.

16. **The Operational Boundary for External Debt** –The proposed operational boundary for external debt is based on the Authority's plans for capital expenditure and financing and is consistent with its treasury management policy, statement and practices. The Authority has a number of projects where the best solution may be to lease rather than buy; therefore the limit recognises that such leases may be classified as finance leases. Risk analysis and risk management strategies have been taken into account, as have estimates of the capital financing requirement and estimates of cash flow requirements for all purposes when determining this limit. The Director of Finance and Corporate Services confirms that the operational boundary is based on the estimate of most likely, prudent but not worst- case scenario. This indicator is a key management tool for in-year monitoring. The operational boundary for external debt excluding investments is shown in **Table 6** below.

| **Table 6** | **Operational Boundary for External Debt** | | | |
|---|---|---|---|---|
| | **2012/13 Forecast Outturn** | **2013/14 Estimate** | **2014/15 Estimate** | **2015/16 Estimate** |
| | **£'000** | **£'000** | **£'000** | **£'000** |
| Borrowing | 14,000 | 21,000 | 26,000 | 26,000 |
| Other long term liabilities | 2,000 | 2,000 | 2,000 | 2,000 |
| **Total** | **16,000** | **23,000** | **28,000** | **28,000** |

17. **Authorised Limit for External Debt** - The authorised limit provides for additional headroom over and above the operational boundary to allow for unusual and unexpected cash movements. The authorised limit for the Authority's total external debt, excluding investments is shown in **Table 7** below.

| **Table 7** | **Authorised Limit for External Debt** | | | |
|---|---|---|---|---|
| | **2012/13 Forecast Outturn** | **2013/14 Estimate** | **2014/15 Estimate** | **2015/16 Estimate** |
| | **£'000** | **£'000** | **£'000** | **£'000** |
| Borrowing | 19,000 | 27,000 | 30,000 | 30,000 |
| Other Long Term Liabilities | 2,000 | 2,000 | 2,000 | 2,000 |
| **Total** | **21,000** | **29,000** | **32,000** | **32,000** |

18. **Prospects for Interest Rates** - The Authority's Treasury Management Advisor provides the Authority with economic and interest rate forecasts and information on counterparties. The Advisor's view on future interest rates reflects the 0.2% reduction introduced by the PWLB and is detailed below in **Table 8.** It can be seen from the table below that the base rate is expected to remain low for the foreseeable future with no increase forecast until March 2015. PWLB rates show a gradual but small increase over the next two years.

| **Table 8** | **Future Interest Rate Forecasts** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Dec | Mar | June | Sept | Dec | Mar | Sept | Mar | Sept | Mar |
| | 2012 | 2013 | 2013 | 2013 | 2013 | 2014 | 2014 | 2015 | 2015 | 2016 |
| | % | % | % | % | % | % | % | % | % | % |
| Base Rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 | 1.25 | 1.75 |
| 5 yr. PWLB Rate | 1.50 | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.80 | 2.20 | 2.50 | 2.90 |
| 10yr PWLB Rate | 2.50 | 2.50 | 2.50 | 2.60 | 2.60 | 2.70 | 2.80 | 3.20 | 3.50 | 3.90 |
| 25yr PWLB Rate | 3.70 | 3.80 | 3.80 | 3.80 | 3.80 | 3.90 | 4.00 | 4.30 | 4.60 | 5.00 |
| 50yr PWLB Rate | 3.90 | 4.00 | 4.00 | 4.00 | 4.00 | 4.10 | 4.20 | 4.50 | 4.80 | 5.20 |

19. The economic outlook for 2013 remains uncertain and challenging. The UK is expected to struggle to generate positive growth and it is likely that the deficit reduction plans will slip. The US fiscal situation is far from resolved and the US government will hit its debt ceiling in late February which will create uncertainties in the markets as that date approaches. There are still areas of concern in the Eurozone, including the outcome of the Italian elections, and any new developments in Greece and Spain may make the markets nervous.

20. The economic outlook presents several key treasury management implications for the Authority:

- The difficulties in the Eurozone provide a high indication of counterparty risk. This indicates that only high quality counterparties should be used.
- Investment returns are likely to remain relatively low during 2013/14 and beyond.
- PWLB borrowing rates are low and are not expected to rise for some time, therefore the timing of borrowing will need to be monitored carefully.
- The large difference between investment returns means that any borrowing undertaken that results in increased investments will incur a revenue loss between borrowing costs and investment returns.

21. **Borrowing Strategy** - The Authority is currently in an under-borrowed position which means that the capital borrowing needed (the CFR) has not been fully funded from external borrowing. Instead, the Authority has used its temporary surplus cash balances. This is a prudent strategy which has given rise to savings in borrowing interest costs, and thus has minimised the risk of counterparty loss which is potentially high at present.

22. **Use of Cash Flow** – The Authority has provided for an increase in principal and interest costs for new borrowing in the budget but, in the event that the Authority continues to use surplus cash balances instead of borrowing to finance capital expenditure, there will be savings in borrowing interest costs and a slight reduction in investment income. At 31 March 2013 it is estimated that there will be £4,536k of unfinanced capital expenditure.

23. **Timing of Borrowing** - Movement in interest rates is a major focus of detailed treasury work and is used to inform borrowing and investment decisions. Officers engaged in treasury management monitor interest rates on a daily basis and receive advice from the treasury management advisor on changes to market conditions, in order that borrowing activity is able to be undertaken at the most advantageous time.

24. **Periods of Borrowing** - In general, the period of borrowing is linked to the life of assets acquired, although regard is also given to the maturity profile of debt in order to mitigate the risks that might arise on any refinancing. However, on occasions, borrowing decisions may be taken to borrow over shorter or longer periods where this is considered to be the cheapest option in the long term.

25. **Sources of Borrowing** - The Authority could borrow from the Public Works Loan Board, European Investment Bank or the money market depending on which terms are the most favourable overall.

**Treasury Management Limits on External Debt**

26. The Treasury Indicators set limits for interest rate exposures in relation to borrowing, investments and the maturity structure of long term borrowing. The objective of these indicators is to restrain the activity of the treasury function within certain limits, thereby managing the risk of refinancing and adverse movements in interest rates.

27. **Interest Rate Exposures for borrowing** – The limits for interest rate exposures expressed as a percentage of the Authority's outstanding borrowing are shown in **Table 9** below:-

| **Table 9** | **Interest Rate Exposures for Borrowing** | | | |
|---|---|---|---|---|
| | **2012/13 Limit** | **2013/14 Limit** | **2014/15 Limit** | **2015/16 Limit** |
| Fixed Interest Rates | 100% | 100% | 100% | 100% |
| Variable Interest Rates | 20% | 20% | 20% | 20% |

28. **Interest Rate Exposures for Investments** - The limits for interest rate exposures expressed as a percentage of the Authority's principal sum invested are shown in **Table 10** below:-

| **Table 10** | **Interest Rate Exposures for Investments** | | | |
|---|---|---|---|---|
| | **2012/13 Limit** | **2013/14 Limit** | **2014/15 Limit** | **2015/16 Limit** |
| Fixed Interest Rates | 100% | 100% | 100% | 100% |
| Variable Interest Rates | 100% | 100% | 100% | 100% |

29. **Maturity Structure of Borrowing** – The upper and lower limits for the maturity structure of borrowing that is at a fixed interest rate are set out in **Table 11** below. The limits take into account the impact of any new borrowing, and provide flexibility to increase borrowing should expenditure be brought forward from 2013/14, or a decision made to borrow in advance if borrowing rates were particularly attractive.

| Table 11 | Maturity Structure of Borrowing | |
|---|---|---|
| | **Upper Limit** | **Lower Limit** |
| Under 12 months | 38% | 2% |
| 12 months and within 24 months | 36% | 1% |
| 24 months and within 5 years | 47% | 4% |
| 5 years and within 10 years | 50% | 9% |
| 10 years and above | 75% | 1% |

30. **Total Principal Sums Invested for Periods Longer than 364 days –** The longest duration for any investment will be six months.

31. **Policy on Borrowing in Advance of Need** - The Authority will not borrow in advance of its needs in order to profit from any interest rate advantage. Any decision to borrow in advance will be within the 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. The risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual treasury reports.

32. **Policy on Debt Rescheduling** - While short term interest rates continue to 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 the debt repayment (premiums incurred). The reasons for rescheduling may include the generation of cash savings in annual interest payments or to amend the maturity profile of the portfolio. Generally the premium now charged by the PWLB makes restructuring debt for interest rate reasons unattractive. Consideration would be given to debt restructuring if there was a significant change in the PWLB policy. Any debt rescheduling will be reported to the Authority at the earliest opportunity following the rescheduling.

33. **Annual Investment Strategy** - The Authority's Investment Policy has regard to the Government Guidance and the TM Code. The Authority's Investment Policy will have two objectives: the first will will be security in order to ensure that the capital sum is protected from loss; the second will be liquidity in order to ensure that cash is available when needed. Once the proper levels of security and liquidity have been determined, the Authority will then consider the yield that can be obtained within these parameters. This strategy is updated annually although, should the need arise, th strategy could be updated during the year with Members' approval.

34. **Specified Investments –** These are investments of not more than one-year maturity or those which could be for a longer period but where the Authority has the right to be

repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small and will include deposits with:

- The Debt Management Office
- Other local authorities
- Money Market Funds
- Banks, building societies and other financial institutions of **high credit quality**

35. **High Credit Quality –** There is no standard definition of high credit quality as this is something that the Government Guidance says should be defined locally. The Authority's treasury management advisor provides a creditworthiness service which takes into account the ratings provided by the credit agencies, market data, market information and information relating to government support for banks, and provides a recommendation on counterparty, group and country limits as well as investment duration. Officers consider this advice, together with other information available and views on risk, to produce a counterparty list. For 2013/14 the Authority will regard organisations which are regarded as UK nationalised banks, or have a Sector recommended maximum duration for investments of 12 months or longer with a positive or stable outlook, as being of high credit quality.

36. The Strategy for 2013/14 will be to use only specified investments on the current counterparty list, detailed in **Annex 2**, for a period not exceeding six months.

37. **Treasury Management Advisor** - The Authority uses Sector Treasury Services as its external treasury management advisor. The Authority recognises that the responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the external service provider. The Authority also has a subscription with the Financial Times and the FT website is monitored by officers on a regular basis. The Authority has a Service Level Agreement (SLA) with the treasury management advisor against which performance is measured on a regular basis.

38. **Training** - The Authority has processes in place to ensure that the appropriate level of training is delivered to both Members and staff who are involved in the delivery and scrutiny of the treasury management function. One member of staff in the Corporate Finance Team holds the treasury management qualification which had been developed specifically for the public sector. The SLA with the treasury management advisor requires them to provide annual training for officers and Members.

**Annex A**

| Summary of Treasury and Prudential Indicators 2012/13 to 2015/16 | | | | |
|---|---|---|---|---|
| | **2012/13** | **2013/14** | **2014/15** | **2015/16** |
| **Prudential Indicators for affordability prudence and capital expenditure** | | | | |
| Ratio Financing Costs to Net Revenue Stream | 1.69% | 1.63% | 1.96% | 2.75% |
| | | | | |
| | **£,000** | **£,000** | **£,000** | **£,000** |
| Revenue Expenditure | 73,418 | 70,976 | 68,945 | 66,378 |
| Revenue Provision for debt repayment | 969 | 969 | 1,003 | 1,187 |
| Capital expenditure | 9,465 | 12,484 | 16,857 | 9,805 |
| CFR as at 31 March | 10,551 | 11,415 | 17,321 | 22,913 |
| Total loans outstanding as at 31 March | 6,015 | 7,323 | 14,540 | 19,707 |
| | | | | |
| **Treasury Indicators** | **£,000** | **£,000** | **£,000** | **£,000** |
| Assumed Operational Boundary for external debt | 16,000 | 23,000 | 28,000 | 28,000 |
| Assumed Authorised Limit for external debt | 21,000 | 29,000 | 32,000 | 32,000 |
| Interest rate exposure for borrowing at fixed rates | 100% | 100% | 100% | 100% |
| Interest rate exposure for borrowing at variable rates | 20% | 20% | 20% | 20% |
| Interest rate exposure for investing at variable rates and fixed rates | 100% | 100% | 100% | 100% |

| Maturity structure of borrowing | **Under 1 year** | **1 to 2 years** | **2 to 5 years** | **5 to 10 years** | **Over 10 years** |
|---|---|---|---|---|---|
| Lower limit | 2% | 1% | 4% | 9% | 1% |
| Upper limit | 38% | 36% | 47% | 50% | 75% |

**Annex B**

| Specified Investments 2013/14 | | |
|---|---|---|
| | **Maximum Maturity Period** | **Minimum Credit Criteria** |
| Cash Deposits with the Debt Management Office | 6 months | N/A |
| Current Accounts with Banks | Liquid | UK Nationalised Bank or Sector Rated for 12 months |
| Call Accounts with Banks | Liquid | UK Nationalised Bank or Sector Rated for 12 months |
| UK Treasury Bills | 6 months | AAA |
| Term Deposits with Other Local Authorities | 6 months | N/A |

| Counterparty Limits 2013/14 | |
|---|---|
| | **Counterparty Limit** |
| Cash Deposits with the Debt Management Office | Unlimited |
| Nat West Bank Current Account | £2m* |
| Nat West Bank Call Account | £2m* |
| Royal bank of Scotland Call Account | £2m* |
| Lloyds Banking Group Call Account | £2m |
| HSBC Call Account | £2m |
| UK Treasury Bills | Unlimited |
| Term Deposits with Other Local Authorities | £5m |

* Limit is applied to RBS/Nat West group to total of £2m