

Annual Treasury Management Strategy 2014/15

1. Introduction

Belfast City Council's Treasury Management Policy is based on the Chartered Institute of Finance and Accountancy (CIPFA) Treasury Management Code of Practice. The policy requires the Director of Finance and Resources to submit an annual Treasury management Strategy to the Council.

This strategy covers the following issues in respect of 2014/15:

- Current treasury position
- Outlook for interest rates
- Capital Financing Plans
- Establishing the Borrowing Requirement
- Borrowing strategy
- Debt rescheduling
- Investments
- Treasury Management Indicators

2. Current Treasury Position

Figure 1 below shows Belfast City Council's treasury position as at 31st March 2013 and 30th September 2013, as well as the projected position at 31st March 2014.

Figure 1
Current and Projected Treasury Position

	31st March 2013 £'000	Average rate	30th Sept 2013 £'000	Average rate	31st March 2014 forecast £'000	Average rate
Borrowing	27,689	5.44%	24,317	6.59%	23,938	5.79%
Investments	28,068	0.50%	34,000	0.57%	37,000	0.50%
Net Borrowing	(379)		(9,683)		(13,062)	

This shows that at the 30th September 2013, the net cash position of the Council has increased by approximately £9m from the 31 March 2013 position. This increase is due to the positive cash flow in the year to date as a result of slippages in the capital programme and the repayment of debt. However, the net cash position of the Council will increase to £13m before 31st March 2014 due to finalisation monies received in November.

3. Outlook for Interest Rates

Market expectations are that interest rates will remain unchanged until April 2015 followed by a series of gradual ¼% increases to a level of 3% in Spring 2018.

4. Capital Financing Plans

It is essential that the level of borrowing is considered within the context of the Council's capital expenditure and plans, as is required by the CIPFA Prudential Code for Capital Finance.

Figure 2 below shows how the reduced capital expenditure and financing plans will impact on the net cash requirement of the Council. It should also be noted that

movement to and from reserves will impact on the cash requirement (i.e. if there are net transfers from reserves, this will create an additional need for cash).

Figure 2
Net Cash Requirement

	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000
Capital Expenditure	11,988	39,026	72,343	30,965
Financed from "other" sources (e.g. grants, contributions, revenue, capital receipts etc)	6,093	11,207	23,350	2,652
Remainder to be "borrowed"	5,895	27,819	48,993	28,313
Notional Repayment of Principal (MRP)	1,174	2,503	4,639	6,636
Increase / (decrease) in CFR	4,721	25,316	44,355	21,676
Transfers (to) / from reserves	(6,000)	3,230	15,730	(2,770)
Net Cash Requirement	(1,279)	28,546	60,085	18,906

The way in which this total funding requirement of £142m for 2014/15-2016/17 is met, is a key consideration of the treasury management strategy. This requirement will increase the net borrowing position of the Council and consideration needs to be given to whether this is met by increasing borrowing, or reducing investment balances.

5 Establishing the Borrowing Requirement

The starting point for ascertain the appropriate level of borrowing is the Capital Financing Requirement (CFR). The CFR is derived from the Balance Sheet and represents the Council's underlying need to borrow for a capital purpose, as it takes account of all capital expenditure incurred which is resourced from borrowing.

However, in addition to the debt position created by historic capital expenditure met from borrowing, the Council also has significant values of reserves, provisions and balances supported by cash, which reduce the net indebtedness of the Council. These positive cash flows allow the Council to consider utilising this cash to support capital expenditure in lieu of external borrowing.

If external borrowing is higher than the CFR, this indicates borrowing in advance of immediate need (permitted within the Prudential Code) and borrowing below CFR would indicate internal borrowing (i.e. the level of cash used in lieu of external borrowing)

At 31st March 2013, the external borrowing of the Council was £13.7m below the total CFR, reflecting the fact that there is a significant level of internal borrowing.

The relatively high levels of reserves and balances on the Council's balance sheet have therefore enabled the Council to benefit from not having to borrow externally to the full extent of the underlying need. However, it cannot be assumed that this position can continue into perpetuity and needs to be given active consideration.

In order to create a framework around the extent to which the council's reserves and balances can continue to be used, the Director of Finance and Resources is recommending an internal limit to be placed on the level of internal borrowing, based

on CIPFA Treasury management Code of Practice that can be used before having to borrow externally. This is known as the Allowable Internal Borrowing limit. This limit has regard to the components of reserves and balances and the estimated longevity of these balances. The Director of Finance and Resources has assessed that of the £47m that existed on the balance sheet at 31st March 2013, approximately £16m will remain for the foreseeable future and that this the amount that may therefore be used in lieu of external borrowing. From the allowable internal borrowing limit, the proposed amount of external borrowing to be held, known as the Liability Benchmark can be determined.

**Figure 3
External Borrowing Requirement**

	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000
Projected closing CFR	46,122	71,437	115,792	137,468
Allowable Internal Borrowing Limit	16,000	16,000	16,000	16,000
Liability Benchmark	30,122	55,437	99,792	121,468
Projected closing borrowing	23,938	23,158	53,681	97,084
Borrowing maturing in year	(3,751)	(779)	(1,756)	(734)
Additional Borrowing Required	6,184	32,279	46,111	24,385
(Increase) / Decrease in Investment Balances	(8,932)	(2,954)	15,730	(2,770)

It should be noted that, in the event of slippage within the capital programme, the CFR may not increase as much as has been forecast and therefore if the external borrowing had been undertaken as planned, internal borrowing would be lower than the limit specified.

6. Borrowing Strategy

In terms of meeting the external borrowing requirement identified above, one of the most important considerations is the timing, in terms of the potential to save significant interest costs and it is key that this position is proactively managed using all information available to inform decisions. It is essential therefore that the considerations of timing of borrowing form a key element of the borrowing strategy.

It is of course not possible for all borrowing to be undertaken at the lowest rates of interest available, as unforeseen events can significantly alter the path of rates. It is therefore essential that the risks to adverse movements are fully understood and actively managed.

One of the key borrowing objectives is to achieve certainty around interest costs, and there is therefore little appetite to undertake variable rate borrowing. It is unlikely that long term interest rates will fall over the medium term and therefore to reduce the risk of rising interest rates, officers will seek to carry out the external borrowing in the financial year to which the expenditure relates.

It is recognised that whilst the capital expenditure and financing plans will be a driver of borrowing costs, the management of risk is the prime objective of the

borrowing strategy and reduction of interest rate risk and refinancing risk within the portfolio is essential.

Therefore, the Council remains prepared to undertake the potential borrowing ahead of immediate need (up to three years in advance), if it results in a reduction of interest rate risk within the portfolio. The Council recognises that this may temporarily increase investment balances, and increase net interest costs in the short term, and that these factors will form part of the decision making process when the strategy is executed. It would be necessary to demonstrate value for money when making a decision in respect of borrowing in advance of need, therefore it will only be undertaken if there is a strong view that rates may rise.

It is expected that requirements for long term borrowing will be met from the Government Loans Fund as, although the costs of borrowing increased in the Comprehensive Spending Review in October 2010, this remains the lowest cost fixed rate borrowing.

7. Debt Rescheduling

The prime objective of any restructuring is to reduce risk in the portfolio, whether that be interest rate or refinancing risk. Any savings that may be created as a result will be considered in the context of the overall risk profile.

Debt restructuring opportunities will be kept under constant review, however the penalties of premature redemption of loans at higher rates than prevailing interest rates mean that there may be significant costs associated with this, which will reduce the attractiveness of opportunities.

8. Investments

Annual Investment Strategy

The Council has regard to the Guidance for Local Government Investments for District Councils in Northern Ireland (the Guidance) as cited under Section 25(1) of the Local Government Finance Act (Northern Ireland) 2011 (the Act) when setting the Investment Strategy. The Department recommends that each local authority produce and publish an Annual Investment Strategy, approved by the Council and revised in year as required. This sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments. This investment strategy states which instruments the Council may use for investment purposes, making a distinction between specified and non-specified investments. This strategy also determines limits in respect of their overall levels.

The prime objective of the Council's investment strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are the security of capital, liquidity of investments and, within those objectives, to secure optimum performance.

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

8.1 Specified Investments

An investment is a **specified investment** if:

- The investment is denominated in Sterling and all payments or repayments are payable only in Sterling,

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- The investment is not a long term investment (i.e. due to be repaid within 12 months of the date in which it was made or one which the Council may require to be repaid within that period),
- The making of the investment is not defined as capital expenditure by virtue of regulation 12 of the Local Government (Capital Finance and Accounting) (Northern Ireland) Regulations 2011; and
- The investment is made with a body which has been awarded a high credit rating, or is made with one of the following:
 - a) The United Kingdom Government;
 - b) A District Council; or
 - c) A Local Authority in England and Wales, or a similar body in Scotland;

The following categories of investments may be used under the definition of specified investments:

- Short term cash deposits
- Call accounts
- Certificates of Deposit (with maturity dates < 1 year)
- UK Government Gilts
- Treasury Bills
- Money Market Funds

The Council considers a high credit rating for money market funds to be those with a long term Fitch Rating of AAA (or the equivalent highest rating from Standard and Poors or Moodys).

The Council will have regard to all 3 rating agencies and considers a high credit rating for other investments to be as follows:

Fitch Credit Rating	Minimum level
Short Term Rating	F1
Long Term Rating	A

Fitch defines these ratings as follows:

A: High credit quality.

'A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

F1: Highest short-term credit quality.

Indicates the strongest intrinsic capacity for timely payment of financial commitments

8.2 Non-specified Investments

In respect of **non-specified investments**. The following instruments have been identified by the Council.

Category of Non-specified investment
Sterling denominated Foreign Government Securities
Sterling medium term Deposits or Certificates of Deposit
Floating rate Certificates of Deposit
Highly rated Corporate Bonds (including investments in a Corporate

Bond Fund)
Sterling Reserve Funds
Index-linked structured deposits
Collateralised deposits
Foreign Currency denominated investments
Deposits with non-rated Building Societies

The Council do not intend on making any investments in the 2014/15 year which meet the definition of non-specified investments and therefore there is no limit set on this within the Investment Strategy.

The CIPFA Code of Practice recommends that the Investment Strategy sets out the maximum period over which investments will be made.

The Director of Finance and Resources recommends that a maximum duration of 2 years should be set, although it is only expected that investments over 12 months will be made in exceptional circumstances.

Regulation 12(1) (d) of the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011 states that some categories of investment are defined as Capital Expenditure. This relates to the acquisition of share or loan capital in any body corporate. However, in the event that this expenditure is made as an investment for the prudent management of the Council's financial affairs, it shall not be treated as capital expenditure.

The impact of investing in instruments of this nature are such that, unlike other investment instruments, either capital or revenue resources would have to be applied to this expenditure, and once the investment was sold or matured, the income would be a capital receipt.

The Council do not intend on making any investments which meet the definition of capital expenditure and therefore there is no limit set on this within the Investment Strategy.

8.3 Investment Risk

The prime consideration of risk within investments is the loss of capital invested. Therefore investments will only be made with bodies with a high credit rating defined above. Credit ratings will form the primary driver for assessing credit quality, although it is recognised that this is not the only means of assessing credit quality.

Caution will be exercised in determining the creditworthiness of investment counterparties, even if they meet the minimum criteria above.

In the event that any institutions are at the minimum criteria and are on negative rating watch, monies will not be placed with that organisation until such time that the negative outlook is revised.

Geographical limits will be considered to ensure an appropriate spread of risk. Sovereign ratings will be taken account of when placing funds with institutions outside of the UK.

Credit ratings for existing investment counterparties will be monitored on a monthly basis, as well as immediately before new deposits are placed.

Market intelligence will also be considered before entering into any investments with proposed counterparties meeting the minimum criteria.

8.4 Treasury Management Advisers

The Council does not currently utilise the services of external advisers when determining the credit quality of its investment counterparties. However, the Director of Finance and Resources reviewed this during 2013/14 and the Council was included in a tender exercise for the appointment of external advisers. The successful company was Arlingclose and it is the Director of Finance and Resources intention to use Arlingclose as the Council's external advisers for the next financial year. The Council recognise that responsibility for the decision to invest with a counterparty rests with the Council as the principle undertaking the transaction.

Credit ratings will be obtained directly from the rating agencies' websites, and officers will regularly read the financial press for information relevant to the credit-worthiness of counterparties.

8.5 Investment Training

The Council recognises that investments, as well as wider treasury management issues require a high level of specialist knowledge. Officers undertaking the decisions are all qualified accountants with many years of experience. However, the Council recognises the need for officers to be kept up to date with developments and through the annual appraisal system will identify any training needs to further enhance the current skills base.

In the event of new Officers joining the function, they will be provided with significant on the job training as well as being provided with the opportunity to attend relevant external training courses.

The Council recognises that although there may be costs involved with sending officers to training courses, when these costs are considered in the context of the size of the portfolios being managed, and the amount of the Council's money at risk, investment in training is a worthwhile area of expenditure.

In addition to the training of officers, in order for elected members to provide effective scrutiny of the strategy and to have the knowledge to make informed decisions regarding the strategy, it is also important that training is provided to Members of the Council.

8.6 Other Investment Considerations

The level of investment balances is not specifically targeted in the strategy; it will be a consequence of the net spending plans of the Council, and the level of external borrowing to be undertaken. To date, balances have remained relatively stable over recent years. However, the introduction of the Prudential Code, and the self regulation of borrowing limits and capital financing strategies, may result in higher or lower levels of balances going forwards as the level of external borrowing is given active consideration.

It should also be noted that the investments are largely as a result of the level of reserves and provisions that the Council has at any one point in time. In addition, there is an amount of working capital (excess of creditors over debtors) as well as being a factor of the extent to which investment balances have been used in lieu of external borrowing.

Section 5 of this report explained the concept of setting a limit on the level of balances and reserves that can be used to support capital expenditure, and as a result, investment balances are expected to decrease as further investment balances are used in lieu of external borrowing.

The remaining cash balances that will not be used in lieu of external borrowing will primarily exist to manage cash flow volatility within the Council. It is therefore not expected that investments of a long term strategic nature will be made. Instead the duration of new investments will remain relatively short in order to meet liquidity demands.

The Council recognises that a consequence of short dated investments is that it exposes the portfolio to interest rate risk, which would otherwise be reduced if investments were made of a long term nature. The current historical low short term rates will limit the risk of further falls in investment rates. The budget for investment income takes a prudent approach to expected returns from investments.

9. Treasury Management Indicators

The CIPFA Treasury Management Code of Practice requires various indicators to be set within the strategy. This section of the report sets these out in the format required by the Code. Whilst they are required to provide boundaries within which the treasury management operations will be managed, it is also important that there is sufficient flexibility to enable officers to react to unforeseen favourable movements in the financial markets which may present beneficial opportunities to the Council.

9.1 Adoption of the CIPFA Code of Practice for Treasury Management

The first Treasury Management Prudential Indicator is that the Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Services. The aim of the Code is for authorities create sound objectives and procedures to ensure decisions are made within an appropriate framework, and to emphasise the overriding importance of effective risk management. In response to this, the Strategic Policy and Resources Committee agreed a Treasury Management Policy for the Council and the Director of Finance and Resources maintains Treasury Management Practices for the effective management and control of the treasury management activities in line with the CIPFA Code of Practice.

9.2 Interest Rate Exposures

The Council is required to set upper limits for both fixed and variable exposures for the forthcoming years. The purpose of this indicator is to contain the Council's exposure to unfavourable movements in interest rates. The indicators are expressed as Fixed Rate Borrowing less Fixed Rate Investments and Variable Rate Borrowing less Variable Rate Investments. The Council defines variable rate investments as including those instruments maturing within each year, as the replacement of those instruments will be subject to prevailing rates of interest. The following table shows the upper limit of fixed rate exposure and the upper limit of variable rate exposure for the forthcoming four years.

	Estimate 2013/14 £'000	Estimate 2014/15 £'000	Estimate 2015/16 £'000	Estimate 2016/17 £'000
Upper limit of fixed rate exposure	44,678	124,177	124,080	123,788
Upper limit of variable rate exposure	(34,857)	(6,439)	(8,687)	(11,368)

9.3 Maturity Structure of Fixed Rate Borrowing

The Council is required to set upper and lower limits of fixed rate borrowing maturing within certain periods, in order to contain the exposure to re-financing risk which

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may arise if significant proportions of borrowing were maturing within a short period of time. The Council has set the following limits for the forthcoming financial year.

	Lower Limit	Upper Limit
Under 12 months	0.00%	20.00%
12 months – 24 months	0.00%	10.00%
24 months – 5 years	10.00%	15.00%
5 years – 10 years	0.00%	30.00%
10 years and above	30.00%	40.00%

9.4 Total Principal Sums invested for periods longer than 364 days

The purpose of this indicator is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of sums invested.

The Council would not, through its normal course of investment activities, expect to make investments beyond 12 months. However, there may be exceptional circumstances which may result in investments being made up to 2 years in duration, as is referred to within the Annual Investment Strategy.

	Estimate 2014/15	Estimate 2015/16	Estimate 2016/17
Total principal sums invested for longer than 364 days	£2m	£2m	£2m