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Purpose: For Noting

Committee report

Committee	AUDIT COMMITTEE
Date	29 SEPTEMBER 2015
Title	REVISION TO TREASURY MANAGEMENT STRATEGY 2015-16
Report of	HEAD OF FINANCE AND SECTION 151 OFFICER

EXECUTIVE SUMMARY

1. This report amends the council's treasury management strategy for 2015-16 to incorporate the borrowing requirements of the waste contract, which was approved by executive and full council on 8 July 2015, and amendments to the 2015-16 capital budget approved by executive on 15 September 2015.
2. It is recommended that the committee note the changes to the treasury management strategy 2015-16.

BACKGROUND

3. The audit committee agreed the annual treasury management strategy 2015-16 at its meeting on 19 February 2015, and recommended it to full council for their approval as part of the council's overall budget strategy. In approving the strategy, the committee agreed a set of prudential indicators, which are intended to ensure that decisions concerning capital expenditure, debt and treasury management are affordable, prudent and sustainable; against which the council's performance will be monitored throughout the year and at year end.
4. At that stage, the financial arrangements for the new waste contract were still being finalised; accordingly no treasury management activities in relation to this contract could be included in the strategy.
5. At the council meeting on 8 July 2015, the preferred bidder for the waste contract was approved. The preferred solution was that the council undertake the borrowing to finance the agreed capital expenditure under the contract, rather than the contractor seeking to fund the expenditure by external borrowing, as this would reduce the cost of the contract to the council.

6. The subsequent executive meeting approved the additional prudential borrowing of up to £80 million over the 25 year life of the contract, to support the capital investment. This borrowing will not add any additional cost to the council, as the cost of borrowing (interest) will be subsumed within the service budget for the contract.
7. As part of a separate decision, at the executive meeting on 15 September 2015, additional capital projects were approved, resulting in a further increase in the borrowing requirement for 2015-16 of £4 million.
8. As a result of those decisions, which could not reasonably have been foreseen at the time the original treasury management strategy was approved for 2015-16, revisions are required to the strategy.
9. The revisions are primarily to the prudential indicators, as described in paragraph 3 above. This will enable the performance of the council's treasury management function to be better monitored during the year and at year end, as it will be compared to more reliable indicators.
10. In addition to the above increased borrowing requirements, the budget report which was presented to council on 2 September 2015 recommended a change in the accounting policy for the minimum revenue provision (MRP) to move the arrangements for writing down pre-2008 capital expenditure from 4% on a reducing balance basis to a straight-line asset life basis with an average asset life of 50 years. This is described in more detail below.

STRATEGIC CONTEXT

11. The Treasury Management Strategy forms part of the council's overall budget strategy, specifically supporting the council's capital programme and the Medium Term Financial Strategy, in line with the [Corporate Plan 2015-17](#) priority 4: Ensuring that all the resources available to the Island are used in the most effective way in achieving the Island's priorities.

CHANGES FROM FEBRUARY 2015 TO SEPTEMBER 2015

12. At its February 2015 meeting, the committee agreed version 2.0 of the Treasury Management Strategy for 2015-16. The revised version, to include the additional borrowing requirements for the waste contract and additional capital expenditure, and the change in MRP policy, is version 3.0.
13. The changes between versions by section are detailed below:

Section 2: External context has been updated for developments up to 30 June 2015, based on information received from the council's treasury management advisers, Arlingclose Limited.

Section 3: Local context has been updated to reflect the council's revised estimated balance sheet at 31 March 2016 and beyond, based on additional

borrowing and increased reserves. The changes in the estimates at 31 March 2016 are shown in the table below:

	TMS February 2015 £m	TMS September 2015 £m
General Fund CFR	259.2	280.2
Less: Other debt liabilities *	(68.2)	(68.2)
Borrowing CFR	191.0	212.0
Less: External borrowing **	(119.4)	(122.9)
Internal borrowing	71.6	89.1
Less: Usable reserves	(35.0)	(52.8)
Less: Working capital surplus	(0.5)	(12.7)
Investments (or New borrowing)	(36.1)	(23.6)

* finance leases and PFI liabilities that form part of the Council's debt

** shows only loans to which the Council is committed at 10 September 2015 and excludes optional refinancing

Although the general fund CFR and the borrowing CFR have both increased, the requirement for additional borrowing has reduced as a result of higher forecast usable reserves and surplus working capital at 31 March 2016 than were estimated in February 2015.

An updated liability benchmark graph has been presented, showing the additional borrowing requirements as a result of the capital expenditure under the waste contract.

Section 4: Borrowing strategy has been updated to reflect the actual borrowing position at 31 August 2015, rather than at 31 January 2015, otherwise no changes.

In addition, the strategy outlines the proposals for financing the waste contract borrowing requirement:

"It is proposed that for the first three years of the waste contract (starting November 2015) all borrowing to finance the capital investment will be sourced from short term (less than 364 days) borrowing, to take account of currently forecast ongoing low interest rates. It is proposed that at specified future dates, parcels of this short term debt will be refinanced via fixed rate, long term debt, to mature at the end of the contract (financial year 2040-41), repayable by equal instalments of principal for the period of the loans."

Section 5: Investment Strategy is unchanged. The original strategy contained broad statements about the investment strategy for the potential capital receipt from the sale of land at Pan, which at this stage are sufficient. Once the scrutiny task and finish group, proposed at full council on 2 September 2015, has met and agreed the detailed investment strategy,

there may be a need for further amendments. However at this stage, the broad statements in the previous strategy remain appropriate.

Section 6: Treasury management indicators have been updated to reflect the changes in the sections above, and the resulting cash flow forecasts.

Section 7: Other items is unchanged.

Section 8: Financial implications is updated to reflect the changes above, and are set out in paragraphs 32 – 35 below.

Section 9: Other options considered is unchanged.

Appendices A and E are unchanged.

Appendix B now reflects the council's actual position at 31 March 2015, as summarised in the changes to section 3 above.

Appendix C has been fully revised to reflect the implications of the additional borrowing requirements on the measures to demonstrate that the council's capital investment plans continue to be affordable, prudent and sustainable.

Appendix D includes the change in accounting policy, amending the calculation of the MRP on capital expenditure incurred before 1 April 2008 from a 4% reducing balance calculation to a straight line 2% calculation. The change is consistent with CIPFA guidance on the calculation of MRP, and has been discussed and agreed in principle with the council's external auditors. This was approved by full council on 2 September 2015 as part of the in-year budget savings proposals, and will deliver a budget saving of approximately £1.3 million in 2015-16, and £1.1 million in 2016-17. The change in accounting policy will become effective from the 2015-16 accounts.

CONSULTATION

14. The additional borrowing requirements for the waste contract and their resulting implications for the treasury management strategy have been discussed at high level by Corporate Management Team and elected members, as part of their approval of the preferred bidder for the contract.
15. The proposals for the borrowing strategy in relation to this contract have been discussed with the council's treasury management advisers, Arlingclose Limited, as well as the treasury management group, which includes the Head of Finance and Section 151 Officer, the Finance Manager – Resources, the Technical Finance Officer, and other senior finance staff.
16. The proposals for the change in accounting policy in respect of the MRP calculation have been discussed, and agreed in principle, with the council's external auditors, Ernst & Young.

FINANCIAL / BUDGET IMPLICATIONS

17. The additional costs of borrowing for the waste contract capital expenditure are projected to be funded from within the agreed operational budget for that contract, and will not incur any additional cost to the council.
18. The indicative budget for investment income from operational cash balances in 2015/16 is minimal, based on an average investment portfolio of £3.0 million at an interest rate of 0.25%.
19. The indicative budget for debt interest paid in 2015/16 is £6.60 million, including an average debt portfolio of £162.1 million at an average interest rate of 4.05%. These figures include the cost of borrowing for the waste project.
20. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.
21. Specific arrangements are in place for the investment of significant capital receipts and earmarked reserves. These are budgeted and accounted for separately from operational activities, and are likely to attract significantly higher rates of return than those forecast for operational surpluses.
22. Other than the above, there are no direct financial or budgetary implications arising from the review of the Treasury Management Strategy and Policy. However, the establishment of effective arrangements for the regular monitoring and review of the council's treasury management arrangements and prudential indicators is a key part of the effective budget management of the council.

LEGAL IMPLICATIONS

23. The Local Government Act 2003 and subsequent regulations require the council to set out its annual strategy with regard to both borrowing and the repayment of external debt. The Act and subsequent regulations require the council to have regard to CIPFA's revised Code of Practice for Treasury Management in Local Authorities, and TMPs. The council is also required to have regard to the CIPFA Prudential Code for Capital Finance, and to set Prudential Indicators for the next three years to ensure the council's investment plans are affordable, prudent and sustainable.

EQUALITY AND DIVERSITY

24. The council has a legal duty under the Equality Act 2010 to seek to eliminate discrimination, victimisation and harassment in relation to age, disability, gender reassignment, pregnancy and maternity, race, religion, sex, sexual orientation and marriage and civil partnerships. The Treasury Management Strategy is not considered to have any impacts upon the equality duties.

RISK MANAGEMENT

25. Treasury management activities have a high level of risk in that they relate to transactions that can amount to several million pounds which are undertaken with external bodies. When the council has surplus monies to invest, there are risks if those organisations to whom it lends default on repayment. The costs to the council of its treasury management activities are dependent on fluctuating interest rates.
26. The overall strategy of borrowing short-term and avoiding long-term debt carries the risk that, if interest rates suddenly rise, when longer term debt is eventually required, it will cost more.
27. The council manages these risks by adopting a treasury management strategy which includes a statement of treasury management practice specifically relating to risk, covering the following risk areas:
 - Credit and counterparty risk – who the council is permitted to lend to and borrow from and what instruments it can utilise.
 - Liquidity risk – ensuring that sufficient, but not excessive, funds are available when needed.
 - Interest rate risk – minimising the council's exposure to significant fluctuations in interest rate, both investment income and borrowing cost, by continually reviewing the instruments it uses.
 - Exchange rate risk – minimising the council's exposure to foreign exchange risk by restricting the exposure to foreign currency investments and overseas counterparties.
 - Refinancing risk – ensuring that the maturity profile of long term debt is as evenly spread as possible, and planning for the replacement of maturing debt at the most favourable interest rates.
 - Legal and regulatory risk – ensuring compliance with regulations and statutory requirements.
 - Risk of fraud, error and corruption – ensuring that appropriate controls are in place around staffing and processes, and ensuring appropriate business continuity arrangements.
 - Market risk – ensuring that the council's treasury management activities are not compromised by adverse economic circumstances.
28. The committee's overview of the council's treasury management arrangements plays an important part in the council's overall financial governance regime. It has an important role to play in the monitoring of treasury management activities, including overview of the risks faced by this function both internally, which are directly controllable through segregation of

duties and reporting arrangements, and externally, controllable through the monitoring of counterparties and lending limits, and also regular monitoring of general economic factors.

RECOMMENDATION

29. It is recommended that the committee note the changes to the revised treasury management strategy 2015-16.

APPENDICES ATTACHED

30. [Appendix 1](#): Treasury Management Strategy 2015-16 – Revised

BACKGROUND PAPERS

31. Annual Treasury Management Strategy 2015-16. Audit committee 19 February 2015 paper B.
<https://www.iwight.com/Meetings/committees/Audit%20Committee/19-2-15/Paper%20F.pdf>
32. Appointment of service provider for the Isle of Wight's integrated waste management contract. Executive 8 July 2015 Paper C
<https://www.iwight.com/Meetings/committees/mod-council/8-7-15/Paper%20C1.pdf>
33. Budget review. Council 2 September 2015 Paper B
<https://www.iwight.com/Meetings/committees/mod-council/2-9-15/Paper%20B.pdf>
34. Bids for additional capital funding in 2015 – 2016. Executive 15 September 2015 Paper F
<https://www.iwight.com/Meetings/committees/Executive/15-9-15/PAPER%20F.pdf>

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