Committee:	**Finance and Administration Committee**	**Agenda Item** **7**
Date:	**10 February 2009**	
Title:	**Treasury Management Strategy & Prudential Indicators 2009/10 – 2011/12**	
Author:	**Stephen Joyce, Chief Finance Officer** **Toby Cowper, Principal Accountant**	Item for decision

Summary

1 Members are requested to approve the Treasury Management strategy and related Prudential Indicators for 2009/10.

2 Investing temporary cash surpluses is becoming problematic due to volatility in the banking system and sharp reduction in interest rates. The strategy sets out how risks will be managed.

3 It is possible that borrowing may be necessary in 2009/10 to support the capital programme. The strategy sets out how this will be done.

4 Prudential Indicators are statutorily required and are intended to ensure that borrowing and investment is carried out in a prudent, affordable and sustainable way.

5 This report, annotated with the Committee's decision, will be submitted to the Full Council on 19 February for final approval.

Recommendations

6 Members are requested to approve for recommendation to Full Council on 19 February:

- The treasury management strategy as set out in this report
- Prudential Indicators as set out in Appendix A.

Background Papers

7 The following papers were referred to by the author in the preparation of this report and are available for inspection from the author of the report.

- CIPFA Code of Practice on Treasury Management
- Guidance provided by the Council's treasury advisers (Arlingclose)
- Treasure Your Assets (Centre for Public Scrutiny Publication)
- The Government's Guidance on Local Government Investments 2004

Impact

Communication/Consultation	Officers have produced this strategy in consultation with financial advisers (Arlingclose).
Community Safety	No specific implications
Equalities	No specific implications
Finance	The report sets out the parameters for the forthcoming year's investments which will impact on the interest earned by the Council on its cash balances. Income and costs arising from the treasury management strategy have been included within the budget report later on the agenda.
Human Rights	No specific implications
Legal implications	The setting of this strategy fulfils requirements set out in the Local Government Act 2003.
Ward-specific impacts	No specific implications
Workforce/Workplace	No specific implications

Background

8 "Treasury Management" is the day to day management of the Council's cash flow, including investing cash surpluses to generate income, borrowing money to cover short term cash shortfalls, and long term borrowing decisions to finance capital spending.

9 Treasury management is strictly regulated by statutory requirements and the CIPFA Code of Practice on Treasury Management. The Council adopted the CIPFA Code in March 2002.

10 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 investment plans are affordable, prudent and sustainable.

11 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy that sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

12 The proposed strategy for 2009/10 is based upon the views of officers on interest rates and market conditions, together with market forecasts and advice provided by the Council's external treasury advisor, Arlingclose. The strategy covers:

- Portfolio position as at 31 March
- Prospects for interest rates
- Borrowing strategy
- Investment strategy
- Prudential Indicators (Appendix A)

Portfolio Position as at 31 March

13 The Council's treasury portfolio position estimated for 2008/09 is shown below:

		Principal as at 01/04/08	Estimated Principal as at 31/03/09	Estimated Average. rate 2008/09
DEBT		£m	£m	%
Fixed rate funding	PWLB	0	0	
	Money Market	0	0	
		0	0	0
Variable rate funding	PWLB	0	0	
	Money Market	0	0	
		0	0	0
Other long-term liabilities	Finance Lease	1.509	1.242	
TOTAL DEBT		**1.509**	**1.242**	
INVESTMENTS				
	Principal held	8.636	6.380 *	4.95
TOTAL INVESTMENTS		**8.636**	**6.380 ***	* Including the £2.2m fixed term deposit with Landsbanki due to mature on the 15/10/08 but not repaid.
	The reduction in principal held is mainly due to the use of capital receipts within the year			

Prospects for Interest Rates

14 The UK economy has entered a recession. The downturn in world commodity, food and oil prices, the lack of domestic wage pressures and weak retail demand is likely to cause a steep decline in inflation in the year ahead.

15 A Bank Rate (currently 1.5%) of 1% or less now seems possible and short-term LIBOR rates of well below 2% will result. Investment rates available to the council on average are likely to be 1.25% with banks and 0.5% with the Government Deposit Account Facility (DMO).

16 Long term borrowing rates currently available to the Council through the PWLB are 3.98% based on a 15 year term.

Borrowing Strategy

17 Currently it is envisaged that the Council will need to undertake long term borrowing (having used all available capital receipts) to finance its capital spending plans. The Council will be required to borrow approximately £400,000 in 2009/10, £800,000 in 2010/11 and £100,000 in 2011/12.

18 This long term borrowing will be taken over a period that reflects the average life of

the assets being purchased, approximately 10 years. Estimated fixed term rates for long term borrowing next year are at 3 – 5%.

19 It is also possible that the Council may need to borrow in the short term to cover any deficit in its cash flow. In such an event, monies would be borrowed from the money market.

Investment Strategy

20 The in year situation for the Council is that the cash flow temporary surplus held by the Council can exceed £20 million at some points during the year. This is due to the cash flow of certain activities e.g. Council Tax collection, business rates collection, government grants and housing rent accounts.

21 The Council needs to have regard to the Government's Guidance on Local Government Investments 2004 and CIPFA's Treasury Management Code of Practice, and the contents of these are used to inform the investment strategy.

22 The primary principle governing the Council's investment criteria is the security of its investments. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments i.e. sufficient funds available to meet payments due. For this purpose it will set out the maximum periods for which funds may be prudently committed.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
- The Council will ensure all investments are made in Sterling and only placed in organisations based in the UK.
- The maximum length for any money market investments will normally be limited up to one year, although short term deposits will be the favoured approach. These Investments will be limited to the organisations that are eligible to access the UK Government Credit Guarantee Scheme; as at 30 January these are:
    - Abbey National plc
    - Bank of Scotland plc
    - Barclays plc
    - Clydesdale Bank
    - HSBC Bank plc
    - Lloyds TSB plc
    - Nationwide Building Society
    - Royal Bank of Scotland

23 The Council will open an investment account with DMO and 3-4 Money Market Fund (MMF) accounts. MMFs are collective investment schemes (i.e. pooled

funds) that invest in short-term debt instruments. They provide the benefits of pooled investment, as investors can participate in a more diverse and high-quality portfolio than they otherwise could individually. MMFs spread risk so that funds are not as vulnerable in the event of a banking failure.

24 The Council will delegate authority to the Chief Finance Officer to amend the Investment strategy (taking into account recommendations from Arlingclose) to keep abreast of the rapidly changing economic environment.

25 The Council acknowledges the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

26 Should interest rates continue to significantly decrease the Council will investigate the use of longer term investments to obtain higher yields. Types of investment that may be considered include: Long term fixed deposits, Bonds (Corporate, Government and Euro Sterling) and Gilts. The other consideration to take into account is that as interest rates drop it becomes less beneficial for the Council to invest money in the short term. Consideration will therefore be given to only using the Council's call accounts and the DMO account, which would also negate the risks associated with external investments.

27 The Chief Finance Officer, under delegated powers, will make the most appropriate form of investment depending on the prevailing interest rates at the time. Longer term fixed rates may be considered earlier if investment rates continue to deteriorate.

28 The Investment Strategy states the categories of investments the Council may use for the prudent management of its treasury balances during the financial year, split between specified and non specified investments, explanations of which are outlined below:

a. Specified Investments

Specified Investments are those investments offering high security and high liquidity, and meet the criteria in the Government's Guidance, i.e. the investment:

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

This Council will make use of the credit ratings published by Fitch Ratings, Moody's Investors Service and Standard and Poor's Ratings to establish the credit quality of its counter parties when investing through the money markets.

The Council has determined the minimum long-term, short-term and other credit ratings it deems to be 'high' for investments purposes. These are:

	Fitch	Moody's	Standard and Poors
Short Term	F1	P1	A1
Long Term	AA-	AA3	AA-
Support Rating	3	n/a	n/a

Given that the Government's investment guidance states that specified investments must have a maturity of less than one year, this Council will ensure that all such investments comply with the short- term ratings of all of the credit ratings agencies listed above.

b. Non-specified Investments

Non-specified Investments will be those that do not exactly fit into the criteria in the Government's Guidance. These investments must be dealt with in more detail given the greater potential risk. Typically the only Non-specified investments that UDC would investigate are long term deposits over a year in length.

29 Credit ratings will be monitored by the Council each time a new investment is placed with a financial institution in-house through its money market brokers. Monthly listings of institutions' credit ratings are issued by the councils treasury advisers 'Arlingclose' and these will be used to determine the suitability of a potential 'deposit taker'. The Council is also alerted to changes in counterparties' credit ratings through regular updates from Arlingclose. If a downgrade results in a counter party no longer meeting the Council's minimum criteria, its further use will be withdrawn immediately, subject to any investments already placed, being allowed to continue to maturity.

30 The Council will receive a report on its investment activity as part of its Annual Treasury Report in September. This complies with the CIPFA Code of Practice on Treasury Management. Additionally there will be update reports to the Finance and Administration Committee.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
Interest rates may fluctuate affecting investment income	2	2	A prudent estimate of investment income has been budgeted for
Loss of funds through no return of deposits	1	4	The new prudent strategy to only invest council funds in the top eight UK based banking organisations and the DMO (all covered by the Bank of England / government's guarantee)

APPENDIX A

Background

1. There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008. The outcome from that review has yet to be published.

Estimates of Capital Expenditure:

2. This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

	Capital Expenditure	**2008/09**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
		Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
	Non-HRA	1.588	1.650	1.759	1.034	0.335
	HRA	1.996	1.996	1.886	1.906	1.930
	Capitalisation	-	1.135	-	-	-
	Total	**3.584**	**4.781**	**3.645**	**2.940**	**2.265**

3. Capital expenditure will be financed as follows:

Capital Financing	**2008/09**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Capital receipts	(1.513)	(2.548)	(1.303)	(0.178)	(0.179)
Government Grants	(0.175)	(0.369)	(0.056)	(0.056)	(0.056)
Major Repairs Allowance	(1.896)	(1.864)	(1.886)	(1.906)	(1.930)
Unsupported borrowing	-	-	(0.400)	(0.800)	(0.100)
Total	**(3.584)**	**(4.781)**	**(3.645)**	**(2.940)**	**(2.265)**

Note: the element to be financed from borrowing impacts on the movement in the Capital Financing Requirement.

Ratio of Financing Costs to Net Revenue Stream:

4. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on costs net of investment income.

	Ratio of Financing Costs to Net Revenue Stream	**2008/09**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
		Approved	Revised	Estimate	Estimate	Estimate
	General Fund	-1.30%	3.00%	4.14%	4.11%	-1.30%
	HRA	-0.29%	-0.23%	-0.05%	-0.08%	-0.08%

Capital Financing Requirement:

5. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure.

	Capital Financing Requirement	**31/3/08**	**31/3/08**	**31/3/09**	**31/3/10**	**31/3/11**
		Approved	Revised	Estimate	Estimate	Estimate
		£m	£m	£m	£m	£m
	Non-HRA	2.114	2.114	1.848	1.942	2.356
	HRA	(0.303)	(0.303)	(0.303)	(0.303)	(0.303)
	Total CFR	**1.811**	**1.811**	**1.545**	**1.639**	**2.053**

6. The year–on-year change in the CFR is due to the following:

Capital Financing Requirement	**2008/09**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Balance B/F	**1.811**	**1.811**	**1.545**	**1.639**	**2.053**
Capital expenditure financed from borrowing	-	-	0.400	0.800	0.100
Revenue provision for debt Redemption.	(0.266)	(0.266)	(0.306)	(0.386)	(0.396)
Balance C/F	**1.545**	**1.545**	**1.639**	**2.053**	**1.757**

7. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should make sure that net external borrowing does not, except in the short term, exceed the Capital Financing Requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.
8. The Chief Finance Officer reports that this Council had no difficulty meeting this requirement in 2008/09 nor are difficulties envisaged for the current or future financial years.

Actual External Debt

9. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

	Actual External Debt as at 31/3/2008	£m
	Borrowing	-
	Other Long-term Liabilities (Finance Lease)	1.242
	Total	**1.242**

Incremental Impact of Capital Investment Decisions:

10. This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

	Incremental Impact of Capital Investment Decisions	**2008/09**	**2009/10**	**2010/11**	**2011/12**
		Revised £	Estimate £	Estimate £	Estimate £
	Proportion of Band D Council Tax	£8.84	£10.50	£11.36	£11.24
	Increase in Average Weekly Housing Rents	£0.08	£0.08	£0.08	£0.08

<u>General Fund</u>

The increase in Band D council tax reflects the increases in the provision for Capital Financing Charges of £0.306 m to undertake borrowing of £1.3m arising from the proposed capital programme 2009/10 – 2011/12.

<u>HRA</u>

The Council's capital plans, as estimated in forthcoming financial years, have a neutral impact on housing rents. This reflects the fact that capital expenditure is predominantly financed from internal resources (grants, contributions, revenue and capital receipts).

Authorised Limit and Operational Boundary for External Debt

11. The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

12. The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

13. The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

14. The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

	Authorised Limit for External Debt	**2008/09**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
		Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
	Borrowing	6.000	6.000	8.000	9.000	10.000
	Other Long-term Liabilities	0.400	1.700	1.600	1.500	1.500
	Total	**6.400**	**7.700**	**9.600**	**10.500**	**11.500**

15. The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

16. The Chief Finance Officer has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Finance and Administration Committee.

Operational Boundary for External Debt	2008/09	2008/09	2009/10	2010/11	2011/12
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Borrowing	4.000	4.000	4.000	5.000	6.000
Other Long-term Liabilities	-	1.742	1.600	1.500	1.500
Total	**4.000**	**5.742**	**5.600**	**6.500**	**7.500**

Adoption of the CIPFA Treasury Management Code:

17. This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council has adopted the CIPFA Code of Practice in Treasury Management.

Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

18. These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net interest paid (i.e. interest paid on fixed rate debt net of interest received on fixed rate investments)

19. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

	2008/09	2008/09	2009/10	2010/11	2011/12
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Upper Limit for Fixed Interest Rate Exposure	11	20	25	25	25
Upper Limit for Variable Rate Exposure	11	20	25	25	25

20. The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

Maturity Structure of Fixed Rate borrowing:

21. This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

22. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Lower Limit £m	Upper Limit £m
under 12 months	0	0
12 months and within 24 months	0	0
24 months and within 5 years	0	0
5 years and within 10 years	0	0
10 years and above	0.400	0.400

Upper Limit for total principal sums invested over 364 days:

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

Upper Limit for total principal sums invested over 364 days	2008/09	2008/09	2009/10	2010/11	2011/12
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
	0	**0**	**0**	**0**	**0**