Committee	**Finance and Administration Committee**	**Agenda Item** **7**
Date	**9 February 2010**	
Title	**Treasury Management Strategy and Prudential Indicators**	
Author	**Toby Cowper, Principal Accountant** **Stephen Joyce, Chief Finance Officer**	Item for decision

Summary

The CIPFA Code of Practice for Treasury Management in Public Services (the "TM Code") requires the Council to determine its Treasury Management Strategy for 2010/11 and Prudential Indicators for the period 2010/11 to 2012/13.

CIPFA revised the TM Code in late November 2009. The Treasury Management Strategy in this report is based on the latest guidance.

To finance the Capital Programme, the Council will need to draw upon its cash deposits in 2010/11 and subsequent years. External borrowing is not forecasted to be necessary until 2014/15.

A prudent approach to managing investments will continue to be followed. However, to provide the required degree if flexibility and to achieve better returns without significant increase of risk, higher counterparty limits, increased use of Money Market Funds and medium-term fixed deposits will be used. No non-UK counterparties will be used and reliance will again be placed upon the UK Government Credit Guarantee Scheme and Government Deposit Account Facility.

Recommendations

Members are requested to approve for recommendation to Full Council on 18 February:

a) The treasury management strategy as set out in this report

b) Prudential Indicators as set out in Appendix B.

Background documents

CIPFA Treasury Management Code
DCLG Investment Guidance
Arlingclose advice

Impact

Communication/Consultation	No specific implications
Community Safety	No specific implications
Equalities	No specific implications
Finance	Details are contained within the report.
Health and safety	No specific implications
Human Rights	No specific implications
Legal implications	The strategy fulfils requirements of the LGA 2003.
Ward-specific impacts	No specific implications
Workforce /Workplace	No specific implications

CIPFA definition of Treasury Management

"the management of the organisation's investments and 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."

Background

Successful risk management is the top priority for treasury management activities. The main risks to the Council's treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk

The Treasury Management Strategy is designed to manage these risks, taking into account the Council's Capital Programme, the current and projected Treasury position (Appendix A), Prudential Indicators (Appendix B) and the outlook for interest rates.

Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

DCLG has recently consulted on proposals to reform the council housing subsidy system. The proposed self-financing option would require a one-off reallocation of housing debt. As the consultation period has only recently ended and the mechanism for debt transfer has not been determined, the estimates set out in this strategy do not take into account any potential debt transfer that may arise in future years.

The move to International Financial Reporting Standards (IFRS) has implications for the Strategy. Analysis of the Council's PFI scheme and operating leases against IFRS requirements may result in the related long term assets and liabilities being brought onto the Balance Sheet. This will influence the determination of the Council's Prudential Indicators.

Outlook for Interest Rates

The interest rate forecast provided by the Council's treasury advisor, Arlingclose, is that the Bank of England base rate will stay at 0.5% for most of 2010/11, possibly rising to 1% in the last quarter. Looking further ahead, the forecast is for steady rises in the interest rate during 2011, reaching 3% in early 2012.

Financial markets remain reasonably volatile as the structural changes necessary within economies and the banking system evolve. This volatility provides opportunities for active treasury management. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

Balance Sheet Position

The Council's level of debt and investments is a key driver of the strategy. The current and forecasted position is set out at Appendix A.

Borrowing Requirement

The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Appendix B. The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.

Capital expenditure not financed from other sources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR (the underlying need to borrow) and in turn produce an increased requirement to charge MRP in the Revenue Account.

Physical external borrowing may be greater or less than the CFR, but in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

Borrowing Strategy

The Council's strategy in the next few years will be to use its cash deposits to fund the Capital programme. The risks to the council that this strategy will create are:

- A reduction in investment income generated from Council balances – but as the current forecast for interest rates is expected to remain at low levels, this will have a minimal impact.
- With the reduction in the Council's cashflow there may be periods when the council is required to take temporary loans to cover the shortfall. The impact of this will be minimal as variable bank rates have fallen to around 1% and are expected to remain so.
- On the positive side this strategy will reduce the Council's exposure on the money markets during the current ongoing uncertainties.

Under this approach, no external borrowing is forecasted to be required until 2014/15.

One point to note is that if the Stansted Housing Partnership draws down its £2.5m balance that the Council holds on its behalf, this could result in the Council having to review or amend this strategy.

The CFO, under delegated powers, will keep this strategy under review. Should market conditions change the Council may need to investigate (with the advice of Arlingclose) long term borrowing, if it becomes necessary.

Investment Policy and Strategy

Investment Policy
The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield commensurate with security and liquidity.

The CLG's recent (draft) revised Guidance on investments reiterates security and liquidity as the primary objectives of a prudent investment policy. The speculative procedure of borrowing purely in order to invest is unlawful.

Investments are categorised as 'Specified' or 'Non Specified' based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendices C and D.

The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Council will continue to maintain a counterparty list based on its criteria and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength.

The Council's current and forecasted level of investments is presented at Appendix A.

Investment Strategy
The global financial market storm has forced investors of public money to reappraise the question of risk versus yield. Income from investments can no longer be considered a key source of funding for the Council. The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates have also been at very low levels, having a significant impact on investment income. The Council's strategy must adhere to the principal objective of security from invested monies.

The CFO, under delegated powers, will undertake the most appropriate form of investments in keeping with this strategy.

Investments managed in-house
The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office.

Currently the Council has restricted its investment activity to:

- The Debt Management Office Deposit Facility (DMO rates of interest are below equivalent money market rates. However, the capital is secure)
- Deposits with other local authorities
- AAA-rated Money Market Funds with a Constant Net Asset Value
- Business reserve accounts and term deposits. (Restricted to UK institutions that have access to the UK Government's Credit Guarantee Scheme)

Continues…

The Council has also taken into account information on corporate developments and market sentiment towards the counterparties. The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

In order to meet requirements of the revised CIPFA Treasury Management Code, the Council is focusing on a range of investment indicators (as stated above), not just credit ratings.

Limits for Specified Investments are set out in Appendix C.

Medium term Investments

To help protect against a prolonged period of low interest rates up to five £1 million fixed term deposits will be invested, with separate UK banking institutions, for a period of 1 year. This is within the limits the Council has set for Non-Specified Investments (see Appendix D).

The table below illustrates the different returns available for differing deposit terms (figures in % as at December 2009)

INSTITUTION	1 MONTH	3 MONTH	6 MONTH	9 MONTH	12 MONTH
RBS	0.40	0.48	0.77	1.00	1.20
SANTANDER UK	0.51	0.80	0.83	1.04	1.24
NATIONWIDE BS	0.41	0.54	0.83	1.03	1.23
BARCLAYS	0.48	0.65	1.00	1.30	1.50

Investments managed externally

Collective Investment Schemes (Pooled Funds):

Pooled Funds (i.e. Money Market Funds) enable the Council to diversify assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.

Investments in Pooled Funds will be undertaken with advice from Arlingclose. The Council's current investments in Pooled Funds are listed in Appendix A; their performance and continued suitability in meeting the Council's investment objectives are regularly monitored.

The Council will invest up to a maximum of 30% of its available cash flow at any one time in Money Market Funds.

Balanced Budget Requirement

The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

2010/11 MRP Statement	The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003. The four MRP options available are: Option 1: Regulatory Method Option 2: CFR Method Option 3: Asset Life Method Option 4: Depreciation Method The Council will apply Option 4. The 2009 SORP and IFRS may result in PFI schemes and leases being brought on balance sheet. Where this is the case the CFR will increase, which will lead to an increase in the MRP charge to revenue. MRP for these items will match the annual principal repayment for the associated deferred liability.
Reporting to Members	The CFO will report to Members on treasury management activity / performance as follows: (a) At each Finance & Administration Committee meeting (b) An outturn report no later than 30th September after the financial year end for approval by Full Council.
Member Training	CIPFA's revised Code requires the CFO to ensure that all members tasked with treasury management responsibilities, including oversight of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. A workshop was help for Members on 24 September 2009. Further training will be provided as needed.

APPENDIX A

INVESTMENTS AND BORROWING

	31 Mar 09 Actual £m	31 Mar 10 Estimate £m	31 Mar 11 Estimate £m	31 Mar 12 Estimate £m	31 Mar 13 Estimate £m
External term Borrowing	0	0	0	0	0
Long-term liabilities	1.903	1.492	1.122	0.856	0.590
Total External Debt	**1.903**	**1.492**	**1.122**	**0.856**	**0.590**
Investments:					
Managed in-house					
- Deposits	4.692	3.000	2.000	2.000	1.500
- Monies on call	4.495	4.500	3.000	3.000	2.000
- Money Market Funds	0	1.000	2.000	2.000	2.000
- Cash at Bank	1.682	1.000	1.000	0.500	0.500
Total Investments	**10.869**	**9.500**	**8.000**	**7.500**	**6.000**
Net Investment position	**8.966**	**8.008**	**6.878**	**6.644**	**5.410**

This table does not take into account the effect that IFRS will have on long-term liabilities (i.e. the PFI)

The above shows the position as at the end of each financial year. Because of cash flow movements during the year, total investments can reach £20m.

PRUDENTIAL INDICATORS 2010/11 TO 2012/13 APPENDIX B

Background

The Local Government Act 2003 requires Local Authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "Prudential Code") when setting and reviewing their Prudential Indicators.

Adoption of the CIPFA TM Code

The Council approved the adoption of the CIPFA Treasury Management Code at its Full Council meeting in March 2002.

Net Borrowing and the Capital Financing Requirement

To ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Council has had no difficulty meeting this requirement in 2009/10, nor are any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Estimates of Capital Expenditure

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	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Non-HRA	1.759	1.990	3.096	1.008	1.825
HRA	1.886	1.925	2.688	1.960	1.975
Total	**3.645**	**3.915**	**5.784**	**2.968**	**3.800**

Capital expenditure will be financed as follows

Capital Financing	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Capital receipts	(1.303)	(1.356)	(1.175)	(0.200)	(0.200)
External funding	(0.456)	(0.634)	(1.272)	(0.165)	(0.060)
Major Repairs Allowance	(1.886)	(1.925)	(1.955)	(1.960)	(1.975)
Revenue contributions	-	-	(0.150)	-	-
Use of cash deposits	-	-	(1.232)	(0.643)	(1.565)
Total	**(3.645)**	**(3.915)**	**(5.784)**	**(2.968)**	**(3.800)**

Ratio of Financing Costs to Net Revenue Stream

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 definition of financing costs is set out at paragraph 87 of the Prudential Code. The ratio is based on costs net of investment income.

Capital Expenditure	2009/10 Approved %	2009/10 Revised %	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %
Non-HRA	2.99%	2.63%	2.83%	1.25%	1.03%
HRA	-0.05%	-0.05%	1.17%	-0.12%	-0.15%

Capital Financing Requirement

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	**31/3/09** Revised £m	**31/3/10** Estimate £m	**31/3/11** Estimate £m	**31/3/12** Estimate £m
Non-HRA	1.566	1.300	1.884	2.204
HRA	(0.303)	(0.303)	0.055	0.055
Total CFR	**1.263**	**0.997**	**1.939**	**2.259**

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

Capital Financing Requirement	**2009/10** Revised £m	**2010/11** Estimate £m	**2011/12** Estimate £m	**2012/13** Estimate £m
Balance B/F	**1.263**	**0.997**	**1.939**	**2.259**
Estimated capital expenditure in the year	3.915	5.784	2.968	3.800
Less amount financed by capital receipts	(1.356)	(1.175)	(0.200)	(0.200)
Less external funding	(2.559)	(3.227)	(2.125)	(2.035)
Less direct revenue financing	-	(0.150)	-	-
Less Minimum Revenue Provision	(0.266)	(0.290)	(0.323)	(0.375)
Balance C/F	**0.997**	**1.939**	**2.259**	**3.449**

The above tables show an increase in the underlying need to borrow to finance the capital programme.

Actual External Debt

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.

Actual External Debt as at 31/03/2009	**£m**
Borrowing	-
Other Long-term Liabilities	1.903
Total	**1.903**

Incremental Impact of Capital Investment Decisions

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	2009/10 Approved £	2009/10 Revised £	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
Increase in Band D Council Tax	£10.50	£9.60	£9.90	£10.52	£11.78
Increase in Average Weekly Housing Rents	£0.08	£0.00	£1.01	£0.00	£0.00

Authorised Limit and Operational Boundary for External Debt

Borrowing can arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (not net of investments). It is measured daily against all external borrowing (long and short term borrowing, overdrawn bank balances and long term liabilities).

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.

Authorised Limit for External Debt	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Borrowing	8.0	5.0	5.5	6.5	7.0
Other Long-term Liabilities	1.6	2.0	1.5	1.5	1.0
Total	**9.6**	**7.0**	**7.0**	**8.0**	**8.0**

The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit but without the additional headroom included within the Authorised Limit.

Operational Boundary for External Debt	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Borrowing	4.0	3.0	3.5	4.5	5.0
Other Long-term Liabilities	1.6	2.0	1.5	1.5	1.0
Total	**5.6**	**5.0**	**5.0**	**6.0**	**6.0**

The CFO 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. Any movement between these limits will be reported to the Finance and Administration Committee.

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

These indicators allow the Council to manage the extent to which its cash deposits are exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums.

	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Upper Limit for Fixed Interest Rate Exposure	25	25	25	25	25
Upper Limit for Variable Interest Rate Exposure	25	25	25	25	25

The limits provide the necessary flexibility within which to manage the Council's cashflow.

Maturity Structure of Fixed Rate borrowing

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. 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. As no external borrowing is anticipated in 2010/11, the limits are set at zero.

Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %
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 within 20 years	0	0
20 years and within 30 years	0	0
30 years and within 40 years	0	0
40 years and within 50 years	0	0
50 years and above	0	0

Upper Limit for total principal sums invested over 364 days

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. As no external borrowing is anticipated during the next 3 years, the limit is set at zero.

Upper Limit for total principal sums invested over 364 days	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	0	0	0	0	0

APPENDIX C

Specified and Non-Specified Investments

Please note the CLG is in the process of undertaking a review of the Investment Guidance for Local Authorities in England and this section would therefore be subject to review and amendment

Specified Investments identified for use by the Council

Specified Investments will be those that meet the criteria in the CLG Guidance.

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).

"Specified" Investments identified for the Council's use are:

Deposits in the DMO's Debt Management Account Deposit Facility
Deposits with English, Welsh or Scottish local authorities
Deposits with banks and building societies
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).
*Certificates of deposit with banks and building societies
*Gilts : (bonds issued by the UK government)
*Bonds issued by multilateral development banks
*AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
*Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

** Investments in these instruments will be on advice from the Council's treasury advisor.*

New specified investments will be made within the following limits:

Instrument	Country	Counterparty*	Maximum Limit of Investments
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits	UK	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK	Santander UK	£3m (Increased from £2m for 2009/10)
Term Deposits/Call Accounts	UK	HBOS	£3m (Increased from £2m for 2009/10)
Term Deposits/Call Accounts	UK	Barclays	£3m (Increased from £2m for 2009/10) UDC holds its current accounts with Barclays PLC. The £3m limit may need to be temporarily exceeded for short periods.
Term Deposits/Call Accounts	UK	Clydesdale	£3m (Increased from £2m for 2009/10)
Term Deposits/Call Accounts	UK	HSBC	£3m (Increased from £2m for 2009/10)
Term Deposits/Call Accounts	UK	Nationwide Building Society	£3m (Increased from £2m for 2009/10)
Term Deposits/Call Accounts	UK	Royal Bank of Scotland	£3m (Increased from £2m for 2009/10)
AAA rated Money Market Funds	UK	Constant Net Asset Value Money Market Funds As at February 2010 the Council's only Money Market Fund is with Goldman Sachs. Officers are currently investigating opening another 3 to 4 Money Market Funds.	£1m (per fund) Maximum 30% of available funds to be placed with MMFs.

*use of banking counterparties subject to registration with UK Government Credit Guarantee Scheme and meeting the minimum credit ratings specified below:

Long-term minimum: A1 (Moody's) and A+ (S&P) and A+ (Fitch)
Short-term P-1 (Moody's) and A-1 (S&P) and F1 (Fitch)

Account will also be taken of information on corporate developments of and market sentiment towards investment counterparties.

Non Specified Investments determined for use by the Council APPENDIX D

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	In-house use	Use by fund managers	Maximum maturity	Capital expenditure?
▪ Deposits with banks and building societies ▪ Certificates of deposit with banks and building societies	✓ ✓	 ✓	1 year	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573) but which are not credit rated	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	No

In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.