ITEM NO: 5

DECISION-MAKER:	COUNCIL			
SUBJECT:	ANNUAL TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2007/08-2010/11			
DATE OF DECISION:	20TH FEBRUARY 2008			
REPORT OF:	CABINET MEMBER FOR RESOURCES PORTFOLIO			
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STRATEGY OF CONFIDENTIALITY
NOT APPLICABLE

SUMMARY

Council is requested to approve the Prudential Indicators and the Treasury Management Strategy and to note the main activities undertaken during 2007/08 which are summarised below:

(i) Investment returns have increased from £2.6M in 2006/07 to an estimated £4.4M in current year. The average rate achieved to date (5.96%) is above the performance indicator of the average 7 day Libid rate (5.71%).

(ii) The average rate for repayment of debt has reduced from 4.90% in 2006/07 to 4.48% as a result of restructuring £29.3M debt. This has generated £150,000 savings in 2007/08 and ongoing savings of £172,000 per annum.

The estimates for interest payable and the Prudential Indicators contained within this report assume that the recommendations in the Capital and Revenue budget reports, elsewhere on the agenda, are approved. If there are any changes to the capital programme or the level of borrowing the Prudential Indicators will need to be revised. As an example, if the RE-charge capital scheme (to be funded from unsupported borrowing) for installing energy saving loans is not approved, there will be an £85,000 per annum revenue saving.

RECOMMENDATIONS:

(i) Approve the Council's Prudential Indicators as detailed in paragraph 10 and within Appendix 1;

(ii) Approve the Treasury Management Strategy for 2008/09 as outlined in the report; and

(iii) To note that the indicators as reported, have been set on the assumption that the recommendations in the reports earlier on the agenda have been approved. Should the recommendations change, the Prudential Indicators may have to be recalculated.

(iv) Note that due to a change in PWLB policy that there are increased costs associated with the premature repayment of debt which is likely to limit the prospects of any meaningful debt rescheduling in future.

REASONS FOR REPORT RECOMMENDATIONS

1. In order to comply with Part 1 of the Local Government Act 2003, and the established treasury management procedures that have been adopted by the Authority, the Council must each year set certain borrowing limits and approve a treasury management strategy.

CONSULTATION

2. The proposed capital and revenue budget on which this report is based have been subject to their own consultation processes outlined in the relevant reports elsewhere on the agenda.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

3. Alternative options for borrowing would depend on decisions taken on the setting of the capital programme, which are being taken today.

DETAIL

Background

4. The Local Government Act 2003 introduced a system based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable.

5. The system is based around the "Prudential Code for Capital Finance in Local Authorities", to which authorities must have regard when setting and reviewing their affordable borrowing limits.

6. The Prudential Code requires that local authorities establish guidelines in advance, by which to judge whether their capital spending plans are affordable, prudent and sustainable and these must be monitored in the light of actual out-turns. It should be noted that CIPFA will be undertaking a review of the code in 2008 to assess whether there are any improvements which could be made.

Treasury Management Strategy:

7. CIPFA has defined Treasury Management as:

   "the management of the organisation's 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."

8. The Council's proposed strategy for 2008-09 takes into account its current treasury position, its projected treasury management and capital financing activities and is based on views on forecast interest rates.

9. The prudential indicators relevant to the treasury management strategy are detailed in the table below:

		2007-08 Estimate	2008-09 Estimate	2009-10 Estimate	2010-11 Estimate
Authorised Limit for External Debt		£359M	£389M	£415M	£427M
Operational Boundary for External Debt		£349M	£378M	£403M	£415M
Upper Limit for Fixed Interest Rate Exposure		100 %	100 %	100 %	100 %
Upper Limit for Variable Rate Exposure		50 %	50 %	50 %	50 %
Upper Limit for total principal sums invested over 364 days		£40M	£40M	£40M	£40M

Maturity structure of fixed rate borrowing :	Estimated % 31/03/2008	Lower Limit %	Upper Limit %
under 12 months	0	0	25
12 months and within 24 months	0	0	25
24 months and within 5 years	0	0	50
5 years and within 10 years	4	0	75
10 years and above	96	0	100

10. 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). The limit has been set not only to include provision for additional borrowing but to provide maximum flexibility for short periods to deliver the agreed Treasury Management strategy.

11. **The current treasury position as at 31st December and the estimate for 31st March 2008 :**

	Actual 31 December 2007		Estimate 31 March 2008	
External borrowing :	Total £'000	Rate %	Total £'000	Rate %
Fixed rate - PWLB	117,500	4.44	127,300	4.43
Fixed rate – Long Term Market	9,000	4.86	9,000	4.86
Fixed rate – Short Term Market	7,900	6.04	10,000	5.50
Variable rate - Market	3,000	4.96	3,000	4.96
Other long-term liabilities	21,700		20,800	
Total external debt	**159,100**		**169,900**	
Investments				
Short-term deposits	52,600	6.27	40,000	5.70
Long-term deposits	28,000	5.71	28,000	5.71
Bonds	1,000	5.47	1,000	5.47

Total Investments	**81,600**		**69,000**	

The estimate for interest payments in 2008-09 is £9.7M and for interest receipts £2.6M.

Borrowing Requirement:

12. The Council's long-term borrowing as at 31 March 2008 is estimated to be £136M. It is estimated that the Council's long-term borrowing requirement over the next 3 financial years will be:

	31/3/2008 £'000	2008-09 £'000	2009-10 £'000	2010-11 £'000
New borrowing to finance capital expenditure	14,312	22,133	12,945	9,065
Replacement of maturing debt	3,500	0	0	0
Less MRP for Debt Redemption	(4,277)	(4,162)	(4,935)	(4,882)
Total	**13,535**	**17,970**	**8,010**	**4,183**

13. The Council prefers to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. Therefore, in conjunction with advice from its treasury advisors, the Council will keep under review the options it has in borrowing from the Public Works Loan Board (PWLB) and from market and other sources identified in the Treasury Management Practices Schedules up to the available capacity within its Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

14. The maturity term of new borrowing will be consistent with the Council maintaining a prudent loans maturity profile in accordance with its Prudential Indicators.

15. **The Option for Forward Funding**: The Council does not have to rely on borrowing in discrete financial years to fund its capital financing requirement and the strategy provides flexibility to take forward borrowing decisions when rates are favourable and the need to borrow can be demonstrated. Overall borrowing must still be within the Council's Affordable Borrowing Limit.

16. **'Trigger' rates for borrowing:** The Council's treasury advisor, provides economic and interest rate forecasts as well as formulating views on borrowing and lending opportunities.

17. Interest rate cycles are becoming shorter and the range in the movement in the repo rates and gilt yields is also becoming smaller. Gilt yields, and consequently PWLB rates are anticipated to fluctuate within a narrow band in 2008-09. The Council views longer term PWLB maturity rates of 4.50% and lower as attractive fixed rate borrowing opportunities and will be advised by our Treasury Management Consultants of the specific timing.

18. The Council will maintain a pragmatic approach to borrowing, bearing in mind the Council's debt maturity profile and the need to minimise borrowing costs without compromising longer-term stability of the portfolio. Total borrowing for the year will be reported to Council in July 2008 as part of the Treasury

Management Outturn report.

Debt Rescheduling:

19. The Council will continue to maintain a flexible policy for debt rescheduling. Market volatility may provide opportunities for restructuring debt from time to time. The rationale for restructuring would be one or more of the following:
    - Savings in interest costs with minimal risk.
    - Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
    - Amending the profile of maturing debt to reduce any inherent refinancing risks.

20. The Council's debt portfolio is monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by the Council's treasury management advisors and discussed with the Council's officers. Any rescheduling activity will be undertaken within the Council's treasury management policy and strategy and will comply with the accounting requirements of the local authority SoRP and regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573). .

21. In 2007/08, up to January 2008, we have restructured debt amounting to £29.3M which has generated savings of £172,000 per annum. This has been achieved at no cost to the authority by grouping loans together where premiums and discounts have been offset. This has resulted in the average rate for debt repayment being reduced from 4.90% in 2006/07 to 4.48% in 2007/08. Total debt restructuring activity for the year will be reported to Council as part of the Treasury Management Outturn report in July 2008.

22. It is unlikely that there will be much scope under the current regulations to undertake any significant debt restructure, as on 1st November 2007 the PWLB introduced a two-tier rate structure in its interest rates to local authorities. The PWLB continued to set daily rates of borrowing for local authorities across the maturity spectrum (1 year to 50 years) but introduced a new lower set of rates that would apply for the premature repayment (rescheduling) of its loans. These premature repayment rates are approximately 0.5% below the borrowing rates for longer term maturities. This increases the costs associated with the premature repayment of debt which could limit the prospects of any meaningful debt rescheduling although the situation will continue to be monitored.

Annual Investment Strategy:

23. The general policy objective is that the Council should invest its surplus funds prudently. The Council's investment priorities are:
    - security of the invested capital.
    - liquidity of the invested capital.
    - an optimum yield which is commensurate with security and liquidity.

The speculative procedure of borrowing purely in order to invest is unlawful, but treasury strategy will result in surplus investments arising from treasury activity from time to time.

24. The Council maintains a counterparty list based on its credit criteria and monitors and updates the credit standing of the institutions on regular basis on the advice of our treasury management consultants. The CFO has delegated powers to determine the counterparty limits to facilitate a prudent and practical diversification of the Council's investments between counterparties. A tiered approach is used to reflect the difference in credit strength between institutions. Due to the increase in the Council's overall investments balances, the individual limits have been reviewed and are revised as follows for investments up to 1 year:

Institutions with a minimum long-term rating in the 'double-A' category or higher (i.e. AAA, AA+, AA, AA- or equivalent) : individual limit increased from £5M to £10M.

Institutions with a long-term rating of A+ or A (or equivalent): individual limit increased from £3M to £5M.

25. Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in government guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix 2.

26. The Council will adhere to the upper limit set under its prudential indicators for 'principal sums invested for over 364 days'.

27. The Council's level of investments at 31st December 2007 was £82M. The Council's investment position is estimated to be:

	31/3/2008	2008-09	2009-10	2010-11
	Estimate	Estimated average	Estimated average	Estimated average
Investments	£69M	£50M	£50M	£50M

28. The Council's shorter term cashflow derived investments are made with reference to the outlook for the repo rate and money market rates. For these monies, the Council will mainly utilise its business reserve accounts and Money Market short term deposits.

29. The Council's core funds, which consist of Schools balances, PFI reserves, and the Housing Revenue and General Fund balances, are invested with a longer-term strategic focus and are currently invested in one year deposits.

As agreed in the 2007/08 strategy, longer-term bonds (which provide certainty of investment income over the life of the bond) were explored and resulted in the purchase of a £1M bond. Further purchase of bonds will be reviewed in consultation with our TM advisors.

30. Based on the forward projections for its investments balances and its budgeted income requirement, the Council will evaluate and consider investment opportunities to earn an optimum return, to build in consistency of return over the medium term to the extent practicable, and to diversify and manage risk.

31. During the year, the Council has worked with its TM advisers to build a rolling investment programme of 1 year cash deposits. This programme should achieve enhanced investment returns and improve both certainty and stability, whilst retaining liquidity. The primary focus is always on the conservation of capital. This programme has helped increase the rate of investment returns from 5.48% in 2006/07 to 5.96% for the current year, which is above the performance indicator of the average 7 day Libid rate, which is currently 5.71%. The forecast for income generated in 2007/08 is £4.4M compared to £2.6M in 2006/07, which is as a result of increased core balances, improved performance and elevated short-dated Libid rates as a result of financial market turbulence due to credit-related concerns; these are now expected to revert to more normal levels.

Balanced Budget Requirement

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

Annual Minimum Revenue Provision (MRP) Strategy

33. MRP is the minimum amount which the Council must charge to revenue for the repayment of debt. Draft Regulations produced by the Department of Communities and Local Government include draft consultation Guidance on MRP issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. This guidance includes a recommendation that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to full council. The statement should indicate which of the four options set out in the Guidance are to be followed in the financial year. The four options available are:

Option 1: Regulatory Method

Option 2: CFR Method

Option 3: Asset Life Method

Option 4: Depreciation Method

The Council is likely to apply Option1 in respect of supported capital expenditure but clarification is currently being sought with both our Financial advisors and the Audit Commission to ensure that this is the most cost effective choice. Option 3 will be followed in respect of unsupported capital expenditure. Details of sums included in the revenue budget are set out in the table below:

	Estimate 2007-08 £'000	Estimate 2008-09 £'000	Estimate 2009-10 £'000	Estimate 2010-11 £'000
MRP on supported borrowing	4,088	3,969	4,289	4,162
MRP on unsupported borrowing	189	193	646	720
Total	**4,277**	**4,162**	**4,935**	**4,882**

Links to the Capital and Revenue Budgets

34. The Treasury Management estimates contained in this report are included within the Revenue budget and are based on the level of borrowing outlined in the Capital Programme reports elsewhere on the agenda. If there are any changes to the level of unsupported borrowing this will affect the estimates for MRP and interest payable. For example if the RE-charge capital scheme (to be funded from unsupported borrowing) for installing energy saving initiatives in private homes is not approved, there will be an £85,000 per annum revenue saving. There will also be an impact on some of the Prudential Indicators. The Incremental Impact on Council Tax (Prudential Indicator No. 5 in Appendix 1) would reduce by 34 pence in 2008/09 and 95 pence in 2009/10.

Report on the Annual Treasury Outturn

35. After the completion of the financial year, the Council will report on its treasury activity during 2007-08. This report will include the latest approved Prudential Indicators for the year together with final outturn position.

FINANCIAL/RESOURCE IMPLICATIONS

<u>Capital</u>

The Capital implications are considered as part of the General Fund Capital Programme report and HRA Capital Programme report elsewhere on the agenda.

<u>Revenue</u>

The Revenue implications are considered as part of the General Fund Revenue Budget report and HRA Revenue Budget report elsewhere on the agenda

<u>Property</u>

None

<u>Other</u>

None

LEGAL IMPLICATIONS

<u>Statutory power to undertake proposals in the report</u>:

Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System.

From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.

Other Legal Implications:

None

POLICY FRAMEWORK IMPLICATIONS

This report has been prepared in accordance with CIPFA's Code of Practice on Treasury Management

SUPPORTING DOCUMENTATION

Appendices

1.	Prudential Indicators for 2007/08 – 2010/11
2.	Specified and Non Specified Investments for use by the Council.

Documents In Members' Rooms

1.	None

Background Documents

	Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
1.	None	

FORWARD PLAN No:	**KEY DECISION?**
WARDS/COMMUNITIES AFFECTED:	