DECISION-MAKER:	AUDIT COMMITTEE COUNCIL
SUBJECT:	ANNUAL TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2011/12 TO 2013/14
DATE OF DECISION:	3 FEBRUARY 2011 16 FEBRUARY 2011
REPORT OF:	INTERIM EXECUTIVE DIRECTOR OF RESOURCES

STATEMENT OF CONFIDENTIALITY
NOT APPLICABLE

BRIEF SUMMARY

Treasury Management is a complex subject and the majority of this report is set out in accordance with statutory requirements and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The information provided is therefore mainly technical, but in essence this information forms the basis of the Treasury Management Strategy and Objectives that are being followed, even if these are not spelt out in simple terms. The purpose of this summary therefore is to interpret this information in such a way that provides Members with key messages on the approach to Treasury Management within the Council.

The core elements of the strategy for 2011/12 are :

- To continue the use of variable rate debt to take advantage of the current market conditions.
- To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To maximise investment returns in line with the Annual Investment Strategy and to constantly monitor global markets to protect the security of our investments.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.

In essence treasury management can always been seen in the context of the classic 'risk and reward' scenario and following this strategy will contribute to the Council's wider Treasury Management objective which is to minimise net borrowing cost in the short term without exposing the Council to undue risk either now or in the longer term.

The minimisation of net borrowing costs contributes to the Council's priority for providing efficient value for money services and active treasury management can help in lessening the impact of both economic conditions and reductions in government funding on the City Council. This has been demonstrated through the use of variable rate loans, the interest on which is currently significantly less than longer term fixed rate loans, which has offset the reduction in investment portfolio income due to lower rates.

This also demonstrates that the Council takes a rounded view to Treasury Management, considering jointly the debt and investment portfolio together rather than one being the consequence of activity in the other.

The Council can also demonstrate integrated thinking through work that it has been doing on balance sheet analysis and forecasting and working with our advisors on potential changes to Housing Revenue Account (HRA) subsidy and debt arrangements. The Council is also very cognisant of the requirements of accounting conventions and changes relating to International Financial Reporting Standards (IFRS). However, these do not drive treasury management decisions and this has been demonstrated by past decisions to undertake major restructuring which then caused huge complexities in representing this in the accounts in line with accounting conventions.

There are a huge number of variables and risks associated with Treasury Management but the key risks and the Council's approach to them are detailed below:

- **Interest Rate Risk** – The Council has exposed itself to interest rate risk by taking out variable debt during 2009 and 2010. This was and continues to be very financially favourable in current markets but does mean that the Council must monitor markets to ensure it is not caught out. During 2011/12 the Council will almost certainly start to take action to lessen this risk through a balanced combination of :-
    - longer term fixed maturity loans,
    - medium term Equal Instalment of Principle (EIP) loans which are currently cheaper than longer term fixed,
    - longer term Public Works Loan Board (PWLB) variable loans which have the option to be fixed at very short notice for a small fee and
    - variable rate investments to take advantage of increasing interest rates, mainly through the use of money market funds (MMF).
- **Investment Risk** – The risks to capital investment are more known now than they have ever been and the Council has a good track record in respect of appropriate risk exposure during the global economic crisis of recent years. Current investment limits and instruments have been set in the context of current conditions and will continue to be monitored and amended as appropriate.
- **Changes in Market Conditions** – The Council must be able to react quickly to changes in market conditions either good or bad and all Treasury Management decisions are taken by the Chief Financial Officer (CFO) in line with the strategy. In addition, decision sheets are signed off by the CFO containing 'trigger points' for market changes which can then be automatically actioned at short notice without the need to get formal sign off on the day. Furthermore, in response to the continued financial uncertainty, this report recommends that the CFO continues to be given delegated authority to make any changes to this strategy that will aid good treasury management. Any decisions made under this power will be reported in full at a later date.

Furthermore, in order to mitigate these risks further, the Council took the opportunity in 2009 to use the savings created by a debt restructure (around £1.5M) to create an Interest Equalisation Reserve which is available to smooth any significant fluctuations in market conditions in future years, so that there is no adverse impact on budgets or council tax in any single year.

In this report, Council is requested to approve the Prudential Indicators and the Treasury Management Strategy and to note the main activities undertaken during 2010/11 to date which are summarised below:

(i) Investment returns are expected to decrease from £1M in 2009/10 to an estimated £0.8M in current year as a result of the continued low interest rates and the fact that income earned in 2009/10 included deals arranged before the decline in the markets which have since matured . The average rate achieved to date (0.99%) is inline with the performance indicator of the average 7 day LIBID rate (0.41%), mainly due to the rolling programme of yearly deals which was restarted in October 2010 following advice from our Treasury Advisors.

(ii) In order to continue to balance the impact of ongoing lower interest rates on investment income we have continued to use short term debt which is currently available at lower rates than long term debt. As a result the average rate for repayment of debt, (the Consolidated Interest Rate – CRI), at 2.97% is lower than that budgeted for but slightly higher than last year (2.82%) which is in line with reported strategy. It should be noted that the forecast for longer term debt is a steady increase over the next few years and so new long term borrowing will be taken out above this rate therefore, leading to an anticipated increase in the CRI (reaching 4.95% by 2013/14).

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.

RECOMMENDATIONS:

Audit Committee is recommended to

(i) Endorse the Treasury Management Strategy for 2011/12 as outlined in the report.

(ii) Note that the indicators as reported have been set on the assumption that the recommendations in the Capital Update report will be approved. Should the recommendations change, the Prudential Indicators may have to be recalculated.

(iii) Note that due to the early timing of this report, changes may still be required following the finalisation of capital and revenue budgets and therefore any significant changes to this report will be highlighted in the final version that is presented to Full Council.

Council is recommended to

(i) Approve the Council's Prudential Indicators as detailed within the report.

(ii) Approve the 2011 MRP Statement.

(iii) Approve the Treasury Management Strategy for 2011/12 as outlined in the report.

(iv) Note that the indicators as reported have been set on the assumption that the recommendations in the Capital Update report will be approved. Should the recommendations change, the Prudential Indicators may have to be recalculated.

(v) Continue to delegate authority to the Chief Financial Officer, following consultation with the Cabinet Member for Resources and Workforce Planning, to approve any changes to the Prudential Indicators or borrowing limits that will aid good treasury management. For example increase the percentage for variable rate borrowing to take advantage of the depressed market for short term rates. Any amendments will be reported as part of quarterly financial and performance monitoring and in revisions to this strategy.

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, each year the Council must set certain borrowing limits and approve a treasury management strategy which includes:
   - Treasury Management Strategy for 2011/12 (Borrowing; paragraphs 20-37, Debt Rescheduling; paragraphs 43-48, Investments; paragraphs 49-62).
   - Prudential Indicators (NB - The Authorised Limit is a statutory limit).
   - MRP Statement – Paragraphs 64-68.
   - Use of Specified and Non-Specified Investments – Appendix 2.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

2. Alternative options for borrowing would depend on decisions taken on the setting of the capital programme, which are being taken at Full Council on 16th February 2011.

DETAIL (Including consultation carried out)

Consultation

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

Background

4. The Local Government Act 2003 introduced a system for borrowing 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 Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury

Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Investment Strategy as required under the DCLG's Investment guidance.

6. CIPFA has defined Treasury Management as:

"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."

The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council. 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 and thereby in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

7. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

To aid the Council in carrying out its Treasury Management function, it has appointed Treasury Management Advisors (Arlingclose) who advise the Council on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the CFO taking into account this advice and other internal and external factors.

8. The Council's proposed strategy for 2011/12 - 2013/14 also takes into account the outlook for interest rates (see Appendix 3) and the Council's current treasury position, projected treasury management and capital financing activities and approved Prudential Indicators.

9. The purpose of this TMSS is to approve:

- Treasury Management Strategy for 2011-12 (Borrowing; paragraphs 20-37, Debt Rescheduling; paragraphs 43-48, Investments; paragraphs 49-62).
- Prudential Indicators (NB - The Authorised Limit is a statutory limit) .
- MRP Statement – Paragraphs 64-68.
- Use of Specified and Non-Specified Investments – Appendix 2.

10. The Council approved the adoption of the CIPFA TM code at is Council meeting on 19th February 2003 and has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

11. All treasury activity will comply with relevant statue, guidance and accounting standards.

Reform to the Council Housing Subsidy System

12. The DCLG published a summary of responses to the consultation held between March and July 2010 on proposals for the reform of the current system of council housing finance which would see the removal of the subsidy system by offering a one-off reallocation of debt. There was widespread agreement with the general methodology proposed in the Prospectus. Many of the reservations related to assumptions about costs and the affordability of allocated debt. There was broader acceptance that a level of housing debt redistribution was an acceptable or necessary price to pay for the freedoms and benefits that the reforms would bring and there was strong support for retaining and clarifying the operation of the HRA ring fence. The Housing Minister confirmed that the new system of HRA self-financing will be most likely implemented in 2012. Full details of the Government's policy on reforming council housing finance will be published in early 2011.

In the Consultation the PwC self-financing model provides an indicative sustainable level of opening housing debt. As the Council's debt level generated by the model is higher than the Subsidy Capital Financing Requirement (SCFR), the Council will be required to pay the DCLG the difference between the two, which is approximately £60M. This will require the Council to fund this amount in the medium term through internal resources and/or external borrowing. The Council has the option of borrowing from the PWLB or the market.

The type of loans taken will be decided on following discussions with the Housing department and the Councils' Treasury Advisors.

All the figures within this report are on based on the position prior to the inclusion of the HRA debt, due to the uncertainty about timing and amounts. It should be noted that this will have a significant impact on the indicators as this will represent an increase of actual debt of approx 25% in 2012 at rates of potentially 6-7% which are significantly higher than our projected portfolio of 4.23%. Any changes will be reported as required.

Balance Sheet and Treasury Position

13. The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) together with Balances and Reserves are the core drivers of Treasury Management Activity. The estimates, based on the current Revenue budget and Capital Programmes, are set out below:

	31/03/2011 Estimate £M	31/03/2012 Estimate £M	31/03/2013 Estimate £M	31/03/2014 Estimate £M
Capital Financing Requirement	**360**	**360**	**356**	**346**
Less: Existing Profile of Borrowing and Other Long Term Liabilities	302	323	316	310
Cumulative Maximum External Borrowing Requirement	**58**	**37**	**40**	**36**
Balances & Reserves	25	15	15	15
Cumulative Net Borrowing Requirement / (Investments)	**33**	**22**	**25**	**21**

14. As the CFR represents the level of borrowing for capital purposes and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of its invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements.

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

Capital Financing Requirement	**2009/10 Actual £M**	**2010/11 Estimate £M**	**2011/12 Estimate £M**	**2012/13 Estimate £M**	**2013/14 Estimate £M**
Balance B/F	**275**	**310**	**360**	**361**	**356**
Capital expenditure financed from borrowing	37	59	11	5	0
Revenue provision for debt Redemption.	(5)	(6)	(8)	(8)	(8)
Movement in Other Long Term Liabilities	3	(3)	(2)	(2)	(1)
Cumulative Maximum External Borrowing	**310**	**360**	**361**	**356**	**347**

Capital Financing Requirement	**2009/10 Actual £M**	**2010/11 Estimate £M**	**2011/12 Estimate £M**	**2012/13 Estimate £M**	**2013/14 Estimate £M**
General Fund	217	256	255	250	241
HRA	93	104	106	106	106
Total CFR	**310**	**360**	**361**	**356**	**347**

Estimates of Capital Expenditure

15. It is a requirement of the Prudential Code to ensure that 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	**2010/11 Approved £000's**	**2010/11 Revised £000's**	**2011/12 Estimate £000's**	**2012/13 Estimate £000's**	**2013/14 Estimate £000's**
General Fund	107,673	92,921	69,426	14,580	9,257
HRA	40,720	38,057	25,892	24,512	0
Total	**148,393**	**130,978**	**95,318**	**39,092**	**9,257**

Capital expenditure is expected to be financed as follows:

Capital Financing	**2010/11 Approved £000's**	**2010/11 Revised £000's**	**2011/12 Estimate £000's**	**2012/13 Estimate £000's**	**2013/14 Estimate £000's**
Capital receipts	5,803	6,684	11,676	7,997	5,719
Government Grants	34,925	26,513	36,998	4,481	2,010
Revenue contributions	13,898	14,241	7,371	1,919	470
Major Repairs Allowance	10,394	10,394	13,096	13,247	0
Revenue	17,137	14,130	15,579	6,382	0
Total Financing	**82,157**	**71,962**	**84,720**	**34,026**	**8,199**
Supported borrowing	8,336	8,336	0	0	0
Unsupported borrowing	57,900	50,680	10,598	5,066	1,058
Total Funding	**66,236**	**59,016**	**10,598**	**5,066**	**1,058**
Total Financing & Funding	**148,393**	**130,978**	**95,318**	**39,092**	**9,257**

Incremental Impact of Capital Investment Decisions

16. This indicator is intended to estimate the impact of capital investment decisions on the Council Tax and rent levels in future years. It compares what the capital financing costs are expected to be with the current approved capital programmes (i.e. the programmes approved in September 2010) with what the capital financing costs are estimated to be if the capital reports proposed elsewhere on the agenda are approved. It is intended to show how the decision to approve the new programme will impact in future years i.e. what the effect of any new borrowing will be on Council Tax and housing rents. (Much of the increase over the 3 years is as a result of adding the 2010/11 schemes to the capital programme and additional unsupported borrowing).

17 For the HRA, the reality is that the rent levels are set under the Government's rent restructuring formula, which is independent of the level of capital investment and borrowing. The calculation of the indicator ignores this factor.

For the General Fund, the incremental impact will not necessarily be passed on to the Tax payers either as other decisions such as cutting back other expenditure may be made to compensate for this increase in future years budget setting.

The incremental impact of capital investments decisions are estimated to be:

Incremental Impact of Capital Investment Decisions	**2010/11 Estimate £**	**2011/12 Estimate £**	**2012/13 Estimate £**	**2013/14 Estimate £**
Increase in Band D Council Tax	3.39	6.76	1.56	2.96
Increase in Average Weekly Housing	10.07	17.03	4.18	7.71

Ratio of Financing Costs to Net Revenue Stream

18. The estimate for interest payments in 2011/12 is £8.5M and for interest receipts is £0.6M. The ratio of financing costs to the Council's net revenue stream 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.

Ratio of Financing Costs to Net Revenue Stream	**2010/11 Approved %**	**2010/11 Revised %**	**2011/12 Estimate %**	**2012/13 Estimate %**	**2013/14 Estimate %**
General Fund	4.99%	6.14%	7.49%	8.43%	9.09%
HRA	5.14%	4.66%	5.75%	7.50%	8.69%
Total	**5.55%**	**5.48%**	**7.09%**	**8.25%**	**8.46%**

The upper limit for this ratio is currently set at 10% to allow for known borrowing decision in the next two years and to allow for additional borrowing affecting major schemes. The table above shows the likely position based on the proposed capital programme. The ratio is based on costs net of investment income.

Outlook for Interest Rates

19. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix 3. 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.

Borrowing, Rescheduling and Strategy

20. The Council's underlying need to borrow for capital purposes is measured by reference to it's CFR as detailed in paragraph 15 above. 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.

21. Capital expenditure not financed from internal resources (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.

22. 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.

23. The cumulative estimate of the maximum long-term borrowing requirement is estimated by comparing the projected CFR with the profile of the current portfolio of external debt and long term liabilities over the same financial horizon and is shown in Appendix 1. This is measured in a manner consistent for comparison with the Authorised Limit and the Operational Boundary.

24. The ***Authorised Limit*** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and 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	2010/11 Approved £000's	2010/11 Revised £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's
Borrowing	361	443	486	536	538
Other Long-term Liabilities	22	81	77	73	71
Total	**383**	**524**	**563**	**609**	**609**

25. 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 reflecting the most likely prudent, but not worst case, scenario but without the additional headroom included within the Authorised Limit.

Operational Boundary for External Debt	2010/11 Approved £000's	2010/11 Revised £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's
Borrowing	351	429	471	522	523
Other Long-term Liabilities	21	73	71	68	67
Total	**372**	**502**	**542**	**590**	**590**

26. 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. 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 Council as part of the Outturn report.

27. The Council's strategy is to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term. A prudent and pragmatic approach to borrowing will be maintained to minimise

borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

28. In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the following borrowing options:
   - PWLB loans
   - Borrowing from other local authorities
   - Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
   - Borrowing from the Money Markets
   - Local authority stock issues
   - Local authority bills
   - Structured finance

29. Even though the cost of new local authority loans has increased to 1% above the cost of the Government's borrowing (following the issuance of Circular 147 on 20th October 2010 as part of the CSR announcement), the PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:
   - Variable rate borrowing
   - Medium-term year Equal Instalments of Principal (EIP) or Annuity Loans
   - Long-term Maturity loans, where affordable

   Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term and maintain stability. The differential between debt costs and investment earnings, (the "cost of carry") remains acute, despite long term borrowing rates being at low levels, and this is expected to remain a feature during 2011/12.

   The "cost of carry" associated with medium and long-term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short-term costs. The use of internal resources in lieu of borrowing may again, in 2011/12, be the most cost effective means of financing capital expenditure.

30. PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long-term rates and variable rates narrows by 0.50%, this will trigger a formal review point and options will be considered in conjunction with the Authority's Treasury Advisor and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.

31. The Council's existing PWLB variable rate loans borrowed prior to 20th October 2010 will be maintained on their initial terms and are not subject to the additional increased margin for new variable rate loans.

32. The Council long term debt includes £9M which are LOBO loans (Lender's Options Borrower's Option) all of which are currently in their option state. In

the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB. The default response will however be early repayment without penalty.

33. Actual borrowing undertaken and the timing will depend on capital expenditure levels, interest rate forecasts and market conditions during the year, in order to minimise borrowing costs. The Council will be advised by its financial advisors of the specific timing of borrowing. This may include borrowing in advance of future years' requirements provided that overall borrowing is maintained within the Council's projected CFR and its approved Affordable Borrowing Limit.

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

35. **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.

36. **'Trigger' rates for borrowing:** The Council's treasury advisors, provide economic and interest rate forecasts as well as formulating views on borrowing and lending opportunities. In addition, decision sheets are signed off by the CFO containing 'trigger points' for market changes which can then be automatically actioned at short notice without the need to get formal sign off on the day.

37. 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 2011 as part of the Treasury Management Outturn report.

Value for Money

38. One of the key elements of the TMSS is to ensure the minimisation of borrowing cost and the maximisation of investment income commensurate with the level of risk exposure the Council feels is appropriate. Whilst recent events have underlined the potential pitfalls of exposure to risk for financial gain, this does not mean that Treasury Management activity can ignore value for money principles.

39. The Council has applied its TMSS in making borrowing and investment decisions and has taken a very active stance in past restructuring and changing both its borrowing and investment portfolio in response to changing market conditions.

40. In terms of assessing value for money, the Council monitors three key indicators, the details of which are shown in the table below and indicate that the direction of travel for the Council is very favourable. Furthermore comparing the Council's CRI with other authorities has shown that the council has one of the lowest rates in the country.

41. The table below shows our target and actual rates for the key Indicators set for Treasury Management:

	Target 2009/10 %	2009/10 Actual %	Target 2010/11 %	2010/11 Actual YTD %	Estimate 2011/12 %	Estimate 2012/13 %	Estimate 2013/14 %
Consolidated Rate of Interest		2.82		2.97			
Temporary Borrowing	0.60	0.43	0.60	0.38	1.00	2.50	3.35
Average Long Term Borrowing	5.00	3.20	5.00	3.32	6.00	6.00	6.00
Temporary Investments	0.58	0.86	0.57	0.99	0.90	2.40	3.25

42. The CRI is shown as actual only, to demonstrate the direction of travel, since it is not practical to set a target for this indicator due to complexities of measuring the overall debt portfolio over time.

Debt Rescheduling

43. 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.

44. The rescheduling of PWLB debt since the introduction of its repayment rates on 1st November 2007 has not ceased, but has become undoubtedly harder and was further acerbated by the 1% increase in PWLB rates, detailed in paragraph 29, as premature repayment rates did not benefit from the corresponding increase and the PWLB' methodology remained unchanged. Rescheduling now places greater emphasis on the timing and type of new borrowing.

45. 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).

46. Borrowing and debt rescheduling activity will be reported as part of quarterly monitoring, as part of outturn and in future updates to this strategy.

47. The following Prudential Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. 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.

The Council's existing level of fixed interest rate exposure is 77% and variable rate exposure is 23% and the limits are shown below:

	2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100
Upper Limit for Variable Interest Rate Exposure	35	50	50	50	50

48. The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt:

	Lower Limit %	Upper Limit %	Actual Fixed Debt as at 31/12/10 £000's	Average Fixed Rate as at 31/12/10 %	% Fixed Rate as at 31/12/10
under 12 months	0	45	44,549	1.64%	28.83%
12 months and within 24 months	0	45	5,000	3.72%	3.24%
24 months and within 5 years	0	50	16,000	3.11%	10.35%
5 years and within 10 years	0	50	23,986	2.83%	15.52%
10 years and within 20 years	0	50			0.00%
20 years and within 30 years	0	75	10,000	4.68%	6.47%
30 years and within 40 years	0	75	30,000	4.62%	19.41%
40 years and within 50 years	0	75	25,000	3.89%	16.18%
50 years and above	0	100	0		0.00%
			154,534	**3.27%**	**100.00%**

Investment Policy and Strategy

Policy

49. Guidance from DCLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set. The Council's investment priorities are:

- security of the invested capital,
- liquidity of the invested capital and
- an optimum yield which is commensurate with security and liquidity.

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

51 The CFO, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to Council as part of the Treasury Management Outturn report in July 2011.

52 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 as outlined in paragraphs 58-60.

Investment Strategy

53 The global financial market storm in 2008 and the continued uncertainty have forced investors of public money to reappraise the question of risk versus yield. Income from investments is key in supporting the Council's budget.

54 The UK Bank Rate has been maintained at 0.50% since March 2009. Short-term money market rates are likely to remain at very low levels which will have a significant impact on investment income. The Council's strategy must however be geared towards this development whilst adhering to the principal objective of security of invested monies. To protect against a lower for longer prolonged period of low interest rates and to provide certainty of income, 2-year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments (see Appendix 2). The longer-term investments will be likely to include:

- Term Deposits with counterparties rated at least A+ (or equivalent)
- Supranational Bonds (bonds issued by multilateral development banks): Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.

55. The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates. The Council's current level of investments is presented at Appendix 1.

56. Changes to the investment strategy for 2011/12 include:

- AAA-rated Variable Net Asset Value (VNAV) Money Market Funds.
- UK Treasury Bills (T-Bills), which are short-term Government debt instruments issued by the Debt Management Office (DMADF).
- Local Authority Bills, which are debt instruments issued by other Local Authorities.
- Term deposits in Sweden.

- Maximum duration for new deposits 2 years.

57. In any period of significant stress in the markets, the default position is for investments to be made with the DMADF or UK Treasury Bills. The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

58. The Council selects countries and the institutions within them (see Appendix 2), for the counterparty list after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+ for counterparties; AA+ for countries)
- Credit Default Swaps (where quoted)
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms/potential support from a well- resourced parent institution
- Share Prices
- Macro-economic indicators
- Corporate developments, news and articles, market sentiment.

59. 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.

60. We do remain in a heightened state of sensitivity to risk. Vigilance is key and this modest expansion of the counterparty list is an incremental step. In order to meet requirements of the revised CIPFA Treasury Management Code, the Council is focusing on a range of indicators (as stated above), not just credit ratings.

61. Limits for Specified Investments are set out in Appendix 2.

62. The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. 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	2010/11 Approved £M	2010/11 Revised £M	2011/12 Estimate £M	2012/13 Estimate £M	2013/14 Estimate £M
	50	50	50	50	50

Balanced Budget Requirement

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

2011/12 MRP Statement

64. 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 options available are:

Option 1: Regulatory Method

Option 2: CFR Method

Option 3: Asset Life Method

Option 4: Depreciation Method

NB This does not preclude other prudent methods

65. MRP in 2011/12: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4, (which may also be used for supported expenditure if the Council chooses).

66. The MRP Statement has to be submitted to Council before the start of the 2011/12 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Council at that time.

67. The Council will apply Option 1 in respect of supported capital expenditure and either Option 3 or 4 in respect of unsupported capital expenditure but this does not exclude any other prudent methods that might meet the needs of the Council. The proposed MRP charges for 2011 are detailed below

	31-Mar-11 Estimate £000's	**31-Mar-12 Estimate £000's**	**31-Mar-13 Estimate £000's**	**31-Mar-14 Estimate £000's**
Supported Borrowing	4,119	4,092	3,808	3,525
Unsupported Borrowing	1,541	3,102	3,364	3,496
HCC Transferred Debt	768	737	707	679
PFI and Finance Leases	2,766	2,481	1,934	2,075
Total MRP	**9,194**	**10,412**	**9,814**	**9,775**

68. MRP in respect of leases brought on Balance Sheet under the IFRS based Code of Practice will match the annual principal repayment for the associated deferred liability.

Monitoring and Reporting on the Annual Treasury Outturn and Prudential Indicators

69. The Chief Financial Officer will report to the Audit Committee on treasury management activity / performance as follows:

(a) A mid year review against the strategy approved for the year.

(b) An outturn report on its treasury activity, no later than 30th September after the financial year end.

70. In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring.

Member Training

71. CIPFA's revised Code requires the responsible officer to ensure that all Members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Training was undertaken on the 10th December 2010.

Investment Consultants

72. To aid the Council in carrying out its Treasury Management function, it has appointed Treasury Management Advisors (Arlingclose) who advise the Council on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the Chief Financial Officer taking into account this advice and other internal and external factors.

RESOURCE IMPLICATIONS

Capital/

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

Revenue

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

Property/Other

75. None

LEGAL IMPLICATIONS

Statutory power to undertake proposals in the report:

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

77. 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:

78. None

POLICY FRAMEWORK IMPLICATIONS

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

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KEY DECISION? No **WARDS/COMMUNITIES AFFECTED:** all

SUPPORTING DOCUMENTATION

Non-confidential appendices are in the Members' Rooms and can be accessed on-line

Appendices

1.	Current and Projected Portfolio Position
2.	Specified and Non Specified Investments for use by the Council.
3.	Economic and Interest Outlook

Documents In Members' Rooms

1.	None

Integrated Impact Assessment

Do the implications/subject of the report require an Integrated Impact Assessment (IIA) to be carried out.	No

Other Background Documents

Integrated Impact Assessment and Other Background documents available for inspection at:

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	