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OXFORD CITY COUNCIL

To: **City Executive Board**
Council

Date: **8th February 2012** **Item No:**
20th February 2012

Report of: **Corporate Director of Finance and Efficiency**

Title of Report: **Treasury Management Strategy for 2011/12 and 2012/13**

Summary and Recommendations

Purpose of report:
To present the revised Treasury Management Strategy for 2011/12 to take account of HRA reform, and the Treasury Management Strategy for 2012/13 together with the Prudential Indicators for 2011/12 – 2015/16.

Key decision? No

Executive lead member: Councillor Ed Turner

Policy Framework: Sustaining Financial Stability

Recommendation(s): City Executive Board is asked to recommend that Council:

1. Adopt and approve the revised Treasury Management Strategy and Prudential Indicators and limits for 2011/12, which have been amended to allow for Housing Revenue Account borrowing, as set out in sections 71 - 95 below.
2. Adopt and approve the Prudential Indicators and limits for 2012/13 to 2015/16 as set out in sections 71 - 95 below.
3. Approve the Minimum Revenue Provision (MRP) statement at paragraphs 15 - 19 which sets out the Council's policy on repayment of debt.
4. Approve the Treasury Management Strategy 2012/13, and the treasury prudential indicators at paragraphs 20 – 48,
5. Approve the Investment Strategy for 2012/13 contained in the treasury management strategy, and the detailed investment criteria as set out in paragraphs 49 – 70, and appendices 1 and 2 attached.

Appendices:
1 – Specified and Non Specified investments
2 – Approved Countries for investments
3 – Risk Register

Executive Summary

1. The Council's Treasury Management Strategy has been written in accordance with the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. There are no significant changes proposed to our General Fund strategy for 2012/13. However, Housing Revenue Account (HRA) reform and the settlement to be made to the Department of Communities and Local Government (CLG) on 28 March 2012 requires that: a) the Strategy for 2011/12 and associated prudential indicators are updated to reflect the Council's borrowing strategy to accommodate the initial 'buy out' from the subsidy system - approx £200m needs to be available by 28th March 2012; and b) that the 2012/13 Strategy and indicators are updated to accommodate subsequent years' borrowing requirements.

2. The report presents the Council's prudential indicators, revised for 2011/12 and estimated for 2012/13 – 2015/16. Notable indicators include capital spend and borrowing limits, as these are areas of significant activity.

3. Members should note the Minimum Revenue Provision (MRP) policy included in paragraph 15-19.

4. The Council has investments of between £30m and £40m on average at any one time during the year. Investments are made in accordance with the Council's Treasury Management Strategy such that returns are balanced against security of investment. These funds are held as investments to ensure that we have liquid cash as required to maintain a stable cashflow.

5. The Council's existing external debt will reduce to £3.5m by the end of March 2012. The debt is held at fixed rates, with varying lengths of time before maturity. The debt is wholly related to Housing with the interest being met through the Housing Revenue Account subsidy mechanism. Restructuring and premature repayment of the debt have been considered, however neither option has historically offered any advantage because any reduction in interest payable would have resulted in an equivalent reduction in subsidy and both options would incur significant costs that would not be met from subsidy. Once we have entered into the new HRA system, where we no longer receive subsidy, repaying of debt will still not be advantageous as there is a large premium that would be payable to PWLB, because these existing debts are at a very high interest rate.

6. The Council also has a long-term liability; this is an outstanding debt with South Oxfordshire District Council and is held at a variable rate, which will reduce to £1.2m by the end of March 2012.

7. The Council's capital programme over the next four years will be funded from a combination of government grants, capital receipts, S106 funding, prudential borrowing and revenue resources. The costs of prudential borrowing are factored into revenue budgets.

Introduction and Background

8. CIPFA defines treasury management as:

   The management of the local authority'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.

9. The Local Government Act 2003 (the Act) and supporting regulations require the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

10. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

11. CIPFA issued revisions to the Prudential Code, Treasury Management Code and Treasury Guidance Notes in mid-November 2011. There is little material change in the revisions which are mainly in relation to the Housing Revenue Account. These changes are included within this report and therefore approval of this report adopts these changes.

12. The primary requirements of the Prudential Code are as follows:

    - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
    - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
    - Receipt by Council of an annual Treasury Management Strategy Statement; including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the scrutiny of its treasury management strategy and policies to a specific named body. For this Council the delegated body is the Value and Performance Scrutiny Finance Panel.

13. The Constitution requires an Annual Strategy to be reported to the City Executive Board, Value & Performance Scrutiny and Full Council outlining the expected treasury activity for the forthcoming 4 years. A key requirement of the report is to explain both the risks, and the management actions mitigating the risks associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year. Additional quarterly performance reporting is also produced to the Value & Performance Scrutiny Finance Panel.

Legal Implications

14. This report fulfils four key legislative requirements:

- The reporting of the prudential indicators setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice

- Agreeing the Council's Minimum Revenue Provision (MRP) policy, which sets out how the Council will pay for capital assets through revenue each year (as required by Guidance under the Local Government and Public Involvement in Health Act 2007)

- Agreeing the treasury management strategy, which sets out how the Council's treasury service will support the capital decisions taken, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing limit required by S3 of the Local Government Act 2003. This is in accordance with the CIPFA code of Practice on Treasury Management and the CIPFA Prudential Code

- Agreeing the investment strategy, which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG investment guidance.

Minimum Revenue Provision (MRP) Statement 2012/13

15. The council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09, and will assess its MRP for 2012/13 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

16. The major proportion of the MRP for 2011/12 will relate to the historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 2 of the guidance. Certain expenditure reflected within the debt liability at 31st March 2012 will be subject to MRP under option 3 and charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be defrayed over the estimated life of that building.

17. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

18. As some types of capital expenditure incurred by the Council are not attributable to an individual asset, asset lives will be assessed on a basis which reasonably reflects the anticipated period of benefit that arises from the expenditure. Expenditure will be consolidated to reflect the nature of the main component of expenditure and will only be divided up where there are two or more major components with substantially different useful economic lives.

19. No depreciation charge is currently required for the HRA. However under HRA reform the HRA will be required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, regulations will allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.

Treasury Management Strategy

Interest Rates

20. Interest rates are important to the Council as we have between £30 million and £40 million of funds in fixed term deposits at any one time (the amount varies during the year). Our deposits are made at or close to prevailing interest rates.

21. Interest rates are currently at an all time low, with Base Rate at 0.50%. It has been at this level since March 2009 and is forecast by a number of

financial advisors including the Council's Treasury Management advisors, Sector Treasury Management Services Ltd to remain at this level until at least September 2013 and then slowly begin to rise thereafter.

Sector's Bank Rate forecast for financial year ends (March 31st)

- 2011/ 2012 0.50%
- 2012/ 2013 0.50%
- 2013/ 2014 1.25%
- 2014/ 2015 2.50%

22. The Finance department manages the Council's cash investments. Assuming an average cash holding of £40 million, a quarter point increase or decrease in interest rates is worth approx £100K per annum.

23. The Council will generally avoid locking into longer term deals (over 364 days) while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by Council.

Borrowing and Debt Strategy 2011/12 – 2015/16

24. The Council had approx £4.38m of external debt as at 1st April 2011, all of which is held at fixed rates, with varying maturity terms up to 2015. The debt is wholly related to Housing with the interest currently met through the Housing Revenue Account subsidy mechanism. Restructuring and premature repayment of the debt have been considered, however neither option offers any advantage because any reduction in interest payable would result in an equivalent reduction in subsidy and both options would incur significant costs that would not be met from subsidy. After 1st April 2012 we no longer receive subsidy and therefore our interest will no longer be covered by this, however repayment of debt is still not an attractive option as the existing debt is at very high interest rates which will lead to a high premium charged by PWLB.

25. During 2011/12 repayments will reduce this debt figure outstanding to approx £3.5m.

26. The Council also has £1.4m of long-term liabilities; this is an outstanding debt with South Oxfordshire District Council and is held at a variable rate, and will reduce to £1.2m by the end of March 2012.

27. The Council's Capital Financing Requirement (CFR) as at 1st April 2011 was £26.0m which is above our current level of external borrowing and is an indication of the Council's underlying need to borrow to fund its capital investments at that time.

28. As at the 31st March 2012 the General Fund CFR is expected to be £1.9m and the HRA CFR is expected to be £224m, with external borrowing of £203.5m. This indicates a potential need to borrow on the external market

in the medium term, if all schemes on the current capital programme go ahead.

29. The S151 Officer has delegated powers to determine the need for any future borrowing depending on the prevailing interest rates at the time, taking into account the risks. A combination of long-term and short-term fixed and variable rate borrowing may be considered. This may include borrowing in advance of future years' requirements. Under normal market conditions, it is likely that shorter term fixed rates may provide lower cost opportunities in the short and medium term, but with the need to monitor long term interest rate increases. However, the situation differs for the HRA reform, as the PWLB is offering a one off discount to buy ourselves out of the subsidy system.

30. The S151 Officer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. The Council will be required to borrow approximately £200m to buy itself out of the current HRA subsidy scheme on 28th March 2012. Following discussion with the Council's Treasury Management advisors, Sector, it is probable that this debt will be taken within a structured profile for variable amounts at fixed interest rates and periods between 15 and 60 years. Estimates of the interest rates and cost of borrowing have been built into the Housing Business Plan.

31. In determining whether borrowing will be undertaken in advance of need the Council will:
    - Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
    - Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
    - Consider the pros and cons of alternative forms of funding
    - Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
    - Consider the impact of borrowing in advance on investment cash balances and the consequent increase in exposure to counterparty risk, and other risk, and the level of such risks given the controls in place to minimise them.

32. In undertaking borrowing, we will consider all options open to us, which include borrowing from banks or building societies, other local authorities and the Public Works Loan Board (PWLB) which is a Government department and provides loans to local authorities.

33. The option of postponing borrowing and running down investment balances known as internal borrowing will also be considered. This is a practice the Council has followed in previous years and reduces counterparty risk and mitigates against the difference in interest payable on borrowing and that earned on investments. To do this requires a clear

understanding of the cashflow requirements of the organisation to ensure a sufficient flow of funds to meet liquidity needs.

34. Council officers, in conjunction with our treasury advisors, Sector, will continually monitor both the prevailing interest rates and the market forecasts, thereby allowing us to respond to any changes in sentiment such that:

- If it were felt that there was a significant risk of a sharp fall in long and short term rates, eg: due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered

- If it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Financing the Buyout of the Housing Revenue Account from the Current Subsidy System

35. Legislation contained within the Localism Act enables the introduction of the HRA Self Financing system from April 2012. Self-financing effectively ends the current subsidy funding system and will enable Oxford City Council to retain all of its HRA dwelling rents in return for a one-off payment covering it's allocated share of the national housing debt figure. For Oxford City this has been estimated at £200m. The existing Housing Subsidy Capital Financing Requirement has been estimated at £24m.

36. The requirement to pay the HRA reform settlement to the Department for Communities and Local Government on 28 March 2012 requires consideration of a borrowing strategy to fund the payment and a subsequent revision of and approval by Council of the Council's existing Treasury Strategy for 2011/12.

37. The Public Works Loans Board (PWLB) is providing loans for the settlement at interest rates up to 0.85% lower than the usual PWLB interest rates (i.e. 30 year maturity loan indicative interest rate of 3.40% through this scheme instead of 4.31% at standard interest rates) and provides a compelling reason to utilise this borrowing facility. Any additional borrowing up to our HRA CFR will not be at the preferential rate. Following discussion with the Council's Treasury Management advisors, Sector, it is probable that this debt will be taken within a structured profile for variable amounts at fixed interest rates and periods between 15 and 60 years. This is considered to be a prudent approach and estimates of the cost of borrowing including provision to repay the debt tranches on maturity have been built into the Housing Business Plan. Whilst the debt

can be drawn down earlier than needed, this will not attract the lower interest rate and therefore will incur a revenue cost equivalent to the difference between borrowing and interest earned on investments. In addition the authority is not in need of the cash to finance existing commitments and would consequently need to invest the surplus cash which in the current financial climate may subject the council to some degree of unnecessary risk.

38. Officers have thoroughly investigated other sources of financing, such as bond issuance and money market loans. However, the set up costs and the interest rates offered by the other options are considerably higher than the special rates offered by PWLB, i.e. a money market loan at prevailing interest rates could be between 0.70% - 0.80% higher than an equivalent PWLB loan, which on £200m, could cost an additional £1.4m - £1.6m interest per annum. On top of this we would also have to pay brokerage fees that would be spread out over the first four years of the loan(s). Hence this facility, for most authorities including Oxford has been ruled out.

39. The Prudential Indicators around authorised external borrowing limits, debt maturity profiles and exposure to fixed and variable debt have been based on the latest debt settlement estimates with some flexibility to cover movements between now and when the debt is taken out on the 28th March. Should the situation change materially details will be reported to the appropriate decision making body at the next available opportunity.

Prudential Borrowing

40. Under the prudential system, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to CIPFA's code of practice. The system is designed to allow authorities that need, and can afford to, to borrow in order to pay for capital investment.

41. The key objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable.

42. The Council intends to undertake prudential borrowing to fund schemes in the capital programme in future years. Associated interest and repayment costs are included in the revenue budgets as appropriate.

43. The prudential system provides a flexible framework within which capital assets can be procured, managed, maintained and developed. At a strategic level it allows authorities to make their own decisions about the balance to be struck between revenue intensive or capital intensive methods of procuring services. It also allows capital investment to proceed where the authority can fund it within prudent and affordable limits. As a consequence these arrangements permit invest to save schemes to proceed where they are not only affordable but also prudent and sustainable.

44. Any prudential borrowing undertaken affects the Council's prudential indicators, and when deciding on our levels of prudential borrowing the Council must have regard to:
    - Affordability e.g.: implications for Council Tax and rent levels
    - Prudence and Sustainability e.g.: implications of external borrowing
    - Value for money
    - Stewardship of assets
    - Service Objectives e.g.: strategic planning for the authority
    - Practicality

45. A fundamental aspect of the prudential system is the ability of each local authority to determine locally the need for capital investment against the option of revenue expenditure. Financial planning has to take into account the range of options for revenue funding and capital investment by:

    - Establishing whether the authority considers it is affordable and prudent to bear the additional future revenue cost associated with additional investment, e.g.: financing and running costs
    - Establishing whether this use of existing or new revenue resources to finance capital investment should have precedence over other competing needs for revenue expenditure
    - Establishing the scope for capital investment to generate future revenue savings or income, taking into account the risks associated with such proposals.

46. The maximum level of prudential borrowing is a matter for the Council to determine. The limits according to legislation and the prudential framework are:
    - To set a balanced revenue budget that includes the revenue consequences of any capital financing i.e.: the revenue budget needs to be able to cover the interest and debt repayment of any borrowing or running costs of the new project
    - The authorised borrowing limit that the Council sets must ensure that borrowing to fund capital projects is reasonable and that the impact on Council tax or council rents is reasonable.

47. Unlike in other sectors where gearing ratios are used to benchmark borrowing levels, there is no mathematical calculation for local authorities to arrive at a limit. Each council must therefore take into account the local circumstances in determining a borrowing level.

48. The Capital programme includes approximately £10.8m of General Fund prudential borrowing for General Fund capital schemes during the period 2012/13 through to 2014/15. The buyout of the HRA subsidy system is also classified as capital expenditure that will be funded by prudential borrowing, this equates to £200m and will be carried out in 2011/12 and hence prudential borrowing of the the four year period 2011-12 to 2014/15 will increase the council's overall external debt by £210 million

Investment Strategy 2012/13 – 2015/16

49. The primary principle governing the Council's investment strategy is the security of its investments; however yield or return on investment is also a key consideration. Other key issues include ensuring the Council:
    - Has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed and that;
    - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

    The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

50. Investment instruments identified for use in the financial year are listed in Appendix 1 under the Specified and Non-Specified investment categories. Counterparty limits will be set through the Council's Treasury Management Practices (TMP's).

    Creditworthiness Policy

51. The Council uses the creditworthiness service provided by Sector. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element, as recommended by CIPFA. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

    - credit watches and credit outlooks from credit rating agencies
    - Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
    - sovereign ratings to select counterparties from only the most creditworthy countries

52. Sector's model combines the credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration of investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

53. Sector's model produces a weekly list of suitable counterparties that the Council can then use, and these are put into colour banks. The Council will therefore use counterparties within the following durational bands*:*

- Purple 2 years (E.g. National Australia Bank Ltd, The Bank of New York Mellon and United Overseas Bank)

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)

- Orange 1 year (E.g. HSBC Bank plc, Standard Chartered Bank and Svenska Handelsbanken)

- Red 6 months (E.g. Santander UK plc, Nationwide Building Society and Barclays Bank plc)

- Green 3 months (E.g. SMBCE, Bank of America N.A. and Swedbank AB)

54. All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.
    - if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
    - if a counterparty's credit ratings are placed on negative watch or negative outlook then officers will carry out a review to determine whether the institution is still worthy of inclusion on the Council's treasury management lending list. If there is any doubt then the institution shall be temporarily suspended pending the credit rating agency's full review.
    - in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

55. In addition to the Sector service the Council will also use market data and market information, information on government support for banks and the credit rating of that government support to inform its investment decisions.

56. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that currently qualify using this criteria are shown in Appendix 2.

57. The S151 Officer will maintain a counterparty list in accordance with the criteria set out above. For operational purposes the list will be reviewed on a daily basis taking into account market information and changes to the criteria provided. This list will be maintained by the Treasury team, and reported to the Section 151 Officer on a regular basis.

58. The S151 Officer has delegated powers to undertake the most appropriate form of investments depending on the prevailing interest rates and security of counterparty at the time.

59. In addition to counterparties that meet Sector's creditworthiness criteria, the Council will also retain the option to place deposits with the top five Building Societies by asset base size. Only the Building Societies with an asset base of £9bn or above will be included on the treasury management lending list. Lending to those societies who do not currently satisfy Sector's minimum credit rating criteria will be restricted to a maximum term of 3 months and no more than 20% of the total investment portfolio or a maximum limit of £3m with any one counterparty.

60. There are currently five Building Societies which have an asset base of over £9bn as shown below:

Building Society	Asset Base*	Fitch Credit Rating
Nationwide	£188,878m	F1/A+
Yorkshire	£30,086m	F2/BBB+
Coventry	£22,302m	F1/A
Skipton	£13,740m	F3/BBB
Leeds	£9,503m	F2/A-

* Figures provided by the Building Societies Association as at each societies year end

61. It should be noted that in light of recent market turbulence and credit rating down grades, officers have decided to temporarily suspend investments with the four smaller institutions listed in the above table. Lending has also temporarily been restricted to a maximum of three months to all other institutions, with the exception of other local authorities or semi-nationalised banks. No changes are required to the overall Treasury Management Strategy as this change is at an operational level. The situation will continue to be reviewed by the treasury team, the Head of Finance and the Section 151 Officer.

62. Limits have also been placed on countries and sectors, as follows:
    - No more than 20% of the previous year's average monthly investment balance with any one counterparty
    - No limit for UK investments
    - Maximum 10% of total investments to be with institutions in other countries that meet the current criteria

63. The Council's bankers are the Co-operative Bank. The credit ratings for this bank do not currently meet the criteria set above. Therefore we are only using the Co-operative for transactional purposes and overnight investments for up to £500k. This is intended to limit our risk but still allow us to utilise the services provided by our house bank.

64. In the normal course of the Council's cash flow operations it is expected that both Specified and Non-specified investments will be used in Treasury Management Operations, these are explained below and in Appendix 2 attached.

65. The use of longer-term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the investment prudential indicator.

66. A Specified investment is one that is in Sterling, is not more than 1 year from inception to repayment, or which could be for a longer period but where the Council has the right to be repaid within that period if it wished. Non specified investments are any other type of investment, these also include the non rated building societies included on our counterparty list.

Icelandic Bank Investments

67. The Council placed deposits with two Icelandic banks prior to their collapse in 2009, original balances were £3m with Heritable and £1.5m with Glitnir. Heritable have repaid 65% of the initial deposit plus interest back and continue to make repayments. It is still expected that we will receive up to 90% back. We have not received any repayments from Glitnir to date, however the Icelandic supreme court have ruled that the Council will be treated as a preferred creditor and it is expected that we will receive close to 100% of our initial deposit back in the next few months. The actual repayment is currently expected to be partially in foreign currency. It is currently too early to provide a definitive policy on how this exchange rate risk will be managed, but the expectation will be that the risk will be managed proactively and assets converted to sterling at the earilest opportunity.

Economic Background

Sector's forward view

68. Growth in the UK economy is expected to be weak over the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee's inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market.

69. Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign

debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

70. This challenging and uncertain economic outlook has a several key treasury mangement implications:
    - The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk which continues to suggest the use of higher quality counterparties for shorter time periods;
    - Investment returns are likely to remain relatively low during 2012/13;
    - PWLB borrowing rates are currently low and may remain low for some time. Hence the timing of borrowing will need to be kept under review
    - The will be cost of capital implications in relation to borrowing in advance due to the differential between borrowing and investment rates.

Prudential Indicators

A. Capital Expenditure Plans

71. The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. The revenue consequences of associated borrowing or ongoing maintenance costs must be accommodated within the Council's revenue budgets.

72. Capital expenditure can be paid for immediately, by applying capital resources such as capital receipts, capital grants, external funding or revenue contributions, but if these resources are insufficient any residual expenditure will add to the Council's borrowing need, or Capital Financing Requirement (CFR).

73. As outlined above the 'buy out' of the HRA from the current subsidy system requires the Council to borrow @ £200m before the 1st April 2012. Hence the Council needs to approve a revised CFR for 2011/12.

74. Estimates of resources such as capital receipts may be subject to uncertainty i.e. anticipated asset sales may be postponed or reduced due to the property market or planning issues.

75. The Council is asked to approve the summary capital expenditure projections below. This is the first prudential indicator:

	2011/12 Original Estimate £000's	2011/12 Revised Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
General Fund	16,726.5	15,284.0	16,895.0	9,296.0	5,058.0	3,846.0
HRA	8,500.0	208,827.0	8,535.0	8,375.0	8,029.0	7,736.0
	25,226.5	224,111.0	25,430.0	17,671.0	13,087.0	11,582.0

B. Capital Financing Requirement (CFR).

76. The CFR is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow. Prudential borrowing is explored in more detail below.

    Council is asked to approve the CFR projections below:

	2011/12 Original Estimate £000's	2011/12 Revised Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
General Fund	14,784	1,980	7,956	11,105	11,838	11,506
HRA	19,715	223,380	223,380	223,380	223,380	223,380
	34,499	225,360	231,336	234,485	235,218	234,886

77. The revised 2011/12 and future years' estimates include the additional HRA borrowing requirement of £200m.

78. The Strategy also includes the Prudential Indicators, which the authority is required to consider before determining its budget and treasury management arrangements for the new financial year. These indicators are a statutory requirement and therefore have to be reported to Council each year. These indicators are split into two categories the first is affordability. Our affordability indicators are listed below:

C. Ratio of Financing costs to the net revenue stream

79. The actual and estimate of the ratio of financing costs to the net revenue stream is shown below, this identifies the trend in the cost of capital against the net revenue stream and shows GF and HRA separately.

	2011/12 Original Estimate £000's	2011/12 Revised Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
General Fund	0.7%	-1.3%	2.1%	1.4%	-0.1%	-0.6%
Housing Revenue Account	5.0%	1.6%	19.3%	18.1%	17.6%	17.0%

D. Incremental impact of capital investment decisions on Council Tax and Rents

Council Tax

80. The estimate of the incremental impact of capital investment decisions on the Council Tax is shown below; this shows the impact of any decisions that are made on investment through the capital programme and how this will ultimately affects the Band D Council Tax.

81. The figures in the table below have been calculated by looking at those schemes that are currently uncommitted in the current Capital Programme and looking at the impact they will have on Council Tax after taking into account capital receipts and revenue contributions.

82. The Council will not enter into any uncommitted capital scheme until the source of funding is confirmed, eg. Capital receipts, grants, S106 or prudential borrowing. This will ensure we can avoid any unplanned impact on Council Tax or other unplanned revenue consequences as a result of capital expenditure.

83. In summary, if the Council were to spend £1m on a new capital project without sources of funding to finance it, this could potentially impact on Band D Council Tax by £0.95.

	2011/12 Original Estimate £	2011/12 Revised Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Overall net impact on Council Tax Band D	25.30	16.26	17.92	9.91	5.37	4.06

Housing Rents

84. The estimated incremental impact of capital investment decisions on weekly housing rents is shown below. The figures have been calculated by looking at those schemes that are currently in the capital programme and deducting alternate funding resources.

85. The key driver for setting our housing rents with effect from 1st April 2012 will be affordability to cover net expenditure (including the take on of the buy out debt). Government formula rent guidance will continue at inflation plus 0.5% until full rent conversion is reached. With the disappearance of the Major Repairs Allowance through Housing Subsidy to fund housing improvements of a capital nature future schemes will be financed directly from Housing rents.

86. For every £1 million that the Council spends on new capital projects without asset sales to finance it will have an impact of £0.11 per week on rents.

	2011/12 Original Estimate £	2011/12 Revised Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Overall net impact on Weekly Housing Rents	27.54	22.66	20.98	20.59	19.74	19.02

87. Dwelling rents are increased in line with Government rent restructuring policy. The value of a property influences the individual level of rent charged.

E. Authorised limit for external debt

88. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Council. It reflects the level of external debt, which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

	2011/12 Estimate £000's	2011/12 Revised Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
General Fund	36,000	2,000	8,000	11,500	12,000	12,000
HRA		243,000	243,000	243,000	243,000	243,000
Other Long Term Liabilities	1,500	1,500	1,500	1,500	1,500	1,500
Total	37,500	246,500	252,500	256,000	256,500	256,500

89. Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is:

HRA Debt Limit	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Total	242,199	242,199	242,199	242,199	242,199

F. Operational boundary for external debt

90. This is based on the expected maximum external debt during the course of the year, it is not a limit, actual external debt can vary around this boundary for short times during the year.

	2011/12 Estimate £000's	2011/12 Revised Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Borrowing	35,000	2,000	8,000	11,500	12,000	12,000
Additional HRA Settlement		234,000	234,000	234,000	234,000	234,000
Other Long Term Liabilities	1,500	1,500	1,500	1,500	1,500	1,500
Total	36,500	237,500	243,500	247,000	247,500	247,500

G. Net Borrowing v CFR

91. The table below shows the Council’s net borrowing position compared to its Capital Financing Requirement. As can be seen, the figures show that the Council is currently borrowing below its financing requirement which indicates a need to borrow in the short to medium

term. The Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

	2011/12 Original Estimate £000's	2011/12 Revised Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Gross Borrowing	34,499	223,380	223,380	223,380	223,380	223,380
Other Long Term Liabilities	1,158	1,400	1,200	1,000	800	600
Total Debt 31 March	35,657	224,780	224,580	224,380	224,180	223,980
Investments	35,000	35,000	35,000	35,000	30,000	30,000
Net Borrowing	657	189,780	189,580	189,380	194,180	193,980
CFR	34,499	223,380	223,380	223,380	223,380	223,380
Net Borrowing v CFR	**33,842**	**33,600**	**33,800**	**34,000**	**29,200**	**29,400**

H. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Sector

92. The Council can confirm that it has complied with this code throughout 2011/12 and will continue to comply with the code throughout 2012/13

I. Upper limit on fixed and variable interest rate borrowing and investments

93. The purpose of this and the following two prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. This indicator identifies the maximum limit for fixed interest rates based upon the debt position net of investments.

	2011/12 Original Estimate %	2011/12 Revised Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Upper limit on fixed rate borrowing	100	100	100	100	100	100
Upper limit on fixed rate investments	100	100	100	100	100	100
Upper limit on variable rate borrowing	100	100	100	100	100	100
Upper limit on variable rate investments	100	100	100	100	100	100

J. Upper and Lower limit for the maturity structure of borrowing

94. These are used to reduce the Council's exposure to large fixed rate sums falling due for repayment at the same time.

	2011/12 Estimate Upper %	2011/12 Estimate Lower %	2012/13 Estimate Upper %	2012/13 Estimate Lower %	2012/13 Estimate Lower %	2013/14 Estimate Upper %	2013/14 Estimate Lower %	2014/15 Estimate Upper %	2014/15 Estimate Lower %
Under 12 months	30	0	30	0	0	30	0	30	0
12 months to 2 years	30	0	30	0	0	30	0	30	0
2 years to 5 years	80	0	80	0	0	80	0	80	0
5 years to 10 years	100	0	100	0	0	100	0	100	0
10 year and above	100	0	100	0	0	100	0	100	0

95. Upper limit for principle sums invested for periods longer than 364 days, this indicator is used to reduce the need for early sale of an investment, and is based on the availability of funds after each year end. This has been set at zero due to the uncertainty of the market and reducing our risk of longer term investments.

	2011/12 Original Estimate %	2011/12 Revised Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
upper limit for investments for periods longer than 364 days	0	0	0	0	0	0

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List of background papers:
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Appendix 1

Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12th March 2004, and this forms the structure of the Council's policy below. The CLG is currently consulting over revisions to the Guidance and where applicable the Consultation recommendations have been included within this policy. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society) For category 5 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is:

	Fitch	Moody's	Standard & Poors	Money Limit	Time Limit
Banks & Building Societies					
Upper Limit Category	F1+/AA-	P-1/Aa3	A1+/AA-	£10.0m or 20% of total investments	>364 days
Middle Limit Category	F1/A-	P-1/A3	A-1/A-	£7.0m or 20% of total investments	<364 days
Unrated Building Societies and those not meeting the minimum criteria					
	Asset base greater than £9bn			£3.0m or 20% of total investments	3 months
Other					
Money Market Funds	-	-	-	£15.0m	364 days
DMO				Unlimited	364 days
Local Authorities				£10.0m	364 days

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
A	**Supranational Bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	AAA long term ratings 10% 10%
B	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	10%
C	**Eligible Institutions** - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.	50%
D	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£500k
E	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which are Eligible Institutions and have a minimum asset size of £0.5bn, but will restrict these type of investments to a maximum totoal of £4m for upto 6 months	£3m

F	Any **bank or building society** that has a minimum long term credit rating of A-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	10%
G	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to the parent company meeting the minimum criteria for a specified investment	10%
H	**Share capital or loan capital*** in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. There is a higher risk of loss with these types of instruments	5%
I	**Pooled property or bond funds*** – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies.	5%

Within categories c, d and f, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies.

In respect of categories h and i, these will only be considered after obtaining external advice and subsequent Member approval.

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector on a weekly basis, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

Appendix 2 – Approved Countries for Investments

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.

AA+

- U.S.A.
- Belgium
- Hong Kong

AA

- Kuwait
- UAE

AA-

- Japan
- Qatar
- Saudi Arabia

* Spain, Italy and Portugal no longer appear on this list as they have been downgraded below AA-.

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