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OXFORD CITY COUNCIL

To:	**City Executive Board and Council**
Date:	**3rd February 2010** **22nd February 2010**
Item No:	
Report of:	**Heads of Finance**
Title of Report:	**TREASURY MANAGEMENT STRATEGY 2010/11**

<u>Summary and Recommendations</u>

Purpose of report:
To seek approval of the Treasury Management Strategy and Prudential Indicators for 2010/11 onwards

Key decision? No

Executive lead member: Councillor Ed Turner

Report approved by:
Councillor Ed Turner
Finance: Sarah Fogden/Penny Gardner
Legal:

Policy Framework: Sustaining Financial Stability

Recommendation(s): The City Executive Board is asked to recommend to Council to:
1. Adopt and approve the Prudential Indicators and limits for 2010/11 to 2012/13 contained within this report.
2. Approve the Minimum Revenue Provision (MRP) statement contained within the report which sets out the Council's policy on MRP
3. Approve the Treasury Management Strategy 2010/11 to 2012/13, and the treasury prudential indicators
4. Approve the Investment Strategy 2010/11 contained in the treasury management strategy, and the detailed criteria.
5. Approve the Counterparty List as attached at Appendix B.
6. The revision to the Council's financial regulations at Appendix A. This revision nominated Value and Performance Scrutiny Committee to ensure effective scrutiny of the treasury management strategy and policies. This is

an accounting instruction that sits underneath the finance rules within the constitution.
7. To increase the affordable borrowing limit to £38m but with the safeguard of earmarking the £5m of uncommitted capital receipts into a reserve to provide a fund from which repayments to this borrowing can be made in exceptional circumstances which mean that these can not be met by revenue savings in the short term.

EXECUTIVE SUMMARY

1. **Capital Expenditure -** the projected capital expenditure for 2010/11 and 2011/12 is expected to be:

	2010/11 Estimate £000's	2011/12 Estimate £000's
General Fund	10,578	4,530
HRA	19,429	6,865
Total	30,007	11,395

2. **Investments** –the Council has investments of between £40 and £50 million at any one time during the year, investments are made at or close to prevailing interest rates in order to aim to achieve our current indicators of 3 month and 7 day Libid.

3. The original approved budget for investment income for 2009/10 was £800k, due to the change in the economic climate during the last year this, and interest rates remaining at an all time low, the forecast has fallen to around £300k. We are on target to achieve this revised figure.

4. Our investment interest forecast for 2010/11 is currently £407k. this is based on investments of £40m at an average rate of 1.01%. There are risks that this will not be achieved because interest rates may not rise as predicted and investments may not be available for us to undertake.

5. **Debt** – the council had £7.18m of external debt as at 1st April 2009, repayments were made during the year reducing this debt down to £5.056m by the end of the financial year. All of this debt is held at fixed rates, with varying lengths of time before maturity. The debt is wholly related to Housing with the interest 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.

6. Our investments total approx £40m at any one time, and our current borrowing level is approx £7m. The borrowing requirements are an

indication of the capital that is needed to fund the capital schemes. The cash investments are required to cover the daily cashflows of the Council, for such items as salaries, payment of invoices, precepts, council tax and NNDR. We have approximately £30m of cash movements within a month and so can invest surplus cash on a short term basis. Cash investments are also used to earn interest.

7. **Debt Requirement** – the Council's capital programme will be funded from resources such as government grants, capital receipts and revenue funding, although there is an element that will not be funded from these direct resources.

8. In synchronisation with the corporate plan and the long term financial plan of the organisation the Council is looking to invest future capital receipts with the aim of earning additional interest, and to use revenue resources to fund capital spend. This spend maybe in full in year one or used to fund prudential borrowing over a number of years. If the latter is chosen this is classified as unsupported borrowing and will therefore increase the Council's Capital Financing Requirement (CFR) each year. The table in paragraph 9 shows our CFR for the current year and future years.

9. The General Fund CFR is reduced each year by the statutory revenue charge for the repayment of debt, the MRP. There is currently no requirement for an MRP charge to reduce the HRA CFR, but the Council has the option to undertake this if it is considered prudent.

	2009/10 Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's
Housing	18,736	19,282	21,584
Non Housing	-4,426	8,280	15,454
Total	**14,310**	**27,562**	**37,038**

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

11. The Council intends to undertake prudential borrowing over the medium term, and any interest costs associated with this will be budgeted for. As potential schemes are put forward they will be assessed on an individual basis prior to their inclusion within the prudential borrowing programme. This will look at the schemes and their ability to spread the costs over a number of years, alongside the affordability, prudence and sustainability of the scheme and its funding.

12. We did not need to undertake any new borrowing in 2009/10, but we will have a need for new borrowing in 2010/11. There a number of approved schemes that will require borrowing to fund them they are Leisure Improvements, building new council houses and playground

refurbishments. There are also a number of proposed schemes that will need borrowing to fund them, they are: Competition Pool; office accommodation; Old Fire Station and Gloucester green toilets.

13. These new schemes are a major investment for the Council and as such will have an impact on the treasury management services and borrowing requirements for the Council. It is important that all prudential indicators reflect the impact that these schemes will have, and that the treasury management strategy is tied in closely with the capital programme for future years.

14. **MRP Statement** – New CLG Guidance have been issued which require full Council to approve an MRP (minimum revenue provision) statement on an annual basis, prior to the start of the year. A variety of options are provided to councils to replace the existing Regulations, so long as there is a prudent provision. The Council is recommended to approve the following MRP statement:

    - For expenditure incurred before 1st April 2008 or which in the future will be supported capital expenditure, the MRP policy will be based on the non-housing CFR (Option 2)
    - From 1st April 2008 for all unsupported borrowing the MRP policy will be:
        - Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations.

    MRP is an equivalent annual cost of which has been allocated for within the revenue budgets in future years.

INTRODUCTION

15. This report outlines the Council's prudential indicators for 2010/11 – 2012/13 and sets out the expected treasury operations for this period. It 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

    - 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)

    - 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

- 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.

16. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2009). This Council adopted the initial edition of the Code and as a result adopted a Treasury Management Policy Statement (Executive Board 26th March 2002), and will adopt the revised code.

17. Revised editions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice were produced in November 2009. the CLG is currently consulting on changes to the Investment Guidance. The revised guidance arising from these Codes has been incorporated within these reports, with the CLG proposals being incorporated where these do not conflict with current guidance. If necessary the Investment Strategy will be revised if any elements of the final CLG Investment Guidance have not already been covered.

18. The main changes initiated in the revisions above increase the Members' responsibility in this area. This will require greater member scrutiny of the treasury policies, increased member training and awareness and greater frequency of information. A members' workshop on Treasury was carried out on 21st December 2009.

19. One element of the revised CIPFA Treasury Management Code of Practice is that the clauses to be adopted as part of the Council's financial regulations be amended. This revision is shown at Appendix A for approval. The key change is that a responsible body be responsible for ensuring effective scrutiny of the treasury management strategy and policies, before making recommendations to Council.

20. The Constitution requires an annual strategy to be reported to City Executive Board, Value & Performance Scrutiny and Full Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of 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.

21. This report revises the indicators for 2009/10, 2010/2011 and 2011/2012 and introduces new indicators for 2012/13. Each indicator reflects the outcome of the Council's underlying capital appraisal systems.

22. The Council's current Treasury Management Strategy for 2009/10 was approved at City Executive Board and Council on 23rd March 2009.

23. The Treasury Management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding and financing of these decisions.

24. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result Council will take a cautious approach to its treasury strategy.

CAPITAL EXPENDITURE PLANS

25. The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government, any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This needs to be affordable, sustainable and prudent. The revenue consequences of this spend will need to be covered from the Council's own resources.

26. This 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.

27. The key risks to the plans are that the level of Government support has been estimated and is therefore perhaps subject to change. Other estimates of resources such as capital receipts may be subject to uncertainty. Anticipated asset sales may be postponed or reduced due to the impact of the declining economy on the property market.

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

Capital Expenditure £m	2009/10 Original £000's	2009/10 Revised £000's	2010/11 Estimated £000's	2011/12 Estimated £000's	2012/13 Estimated £000's
General Fund	12,985	12,790	14,653	11,162	8,719
HRA	11,463	15,027	21,732	9,168	6,865
Financed by:					
Capital receipts	13,151	6,385	20,039	6,483	1,504
Capital grants	10,490	10,827	7,729	5,890	6,360
Supported Borrowing Revenue Backed	892	5,504	6,434	6,027	5,220
Revenue	0	5,101	2,183	1,930	2,500
Capital Reserves	(85)	0	0	0	0
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

29. The figures in the above table do not tie into the budget book as the budget assumes full repayment of prudential borrowing will be in year one, but this repayment is actually over a number of years, usually the life of the asset, and therefore an element of each years spend is still outstanding and therefore is a financing deficit. For example: in 09/10 the play park refurbishment project plans to spend £1.25m but the repayment in year one will be £83k, therefore leaving £1.17m still needing to be funded. This amount therefore increases our CFR temporarily.

30. The second prudential indicator is the council's Capital Financing Requirement (CFR). 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.

31. Council is asked to approve the CFR projections below:

	2008/09 Actual £000's	2009/10 Original Estimate £000's	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Housing	18,190	18,190	18,736	19,282	21,584	23,887
Non Housing	-7,637	-374	-2,911	8,280	15,454	18,229
Total	10,553	18,362	15,825	27,562	37,038	42,116

INTEREST RATES

32. Interest rates are important to the City Council as we have between £40 million and £50 million of funds lent out (the amount varies during the year). Our loans are made at or close to prevailing interest rates.

33. Interest rates are currently at an all time low, with Base Rate at 0.5%. It has been at this level for a number of months now and some economists expect it to stay at this level for at least another 6 months.

34. The Finance department manages the council's cash investment. Assuming average cash holding of £40 million, a quarter point increase or decrease in interest rates is worth approx £100K.

BORROWING AND DEBT STRATEGY 2010/11 – 2012/13

35. The Council had £7.18m of external debt as at 1st April 2009, all of which is held at fixed rates, with varying lengths of time before maturity. The debt is wholly related to Housing with the interest 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.

36. During 2009/10 repayments will reduce debt outstanding to £5.05m at the end of March 2010.

37. The Council also has £1.9m 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 £1.6m by the end of March 2010.

38. The CFR as at 1st April 2009 is £10.5m which is above our external borrowing.

39. As at the 31st March 2010 our CFR is expected to be £15.8m and our external borrowing at £5.05m. This indicates a need to borrow on the external market in the medium term, if all schemes on the current capital programme go ahead.

40. Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. 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. It is likely that shorter term fixed rates may provide

lower cost opportunities in the short and medium term, but watch out for long term interest rate increases.

41. The S151 Officer can decide to borrow in advance of the council's need if there is a reason to do so, this could include a sharp rise in interest rates is expected and therefore borrowing cost would increase by the time the funds are required. 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. Borrowing in advance of need will be made with the constraints that:

    - It will be limited to no more than 20% if the expected increase in borrowing need (CFR) over the three year planning period; and
    - Would not look to borrow more than 12months in advance of need

42. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

43. If the Council were to borrow we would consider the options open to us, which include borrowing from banks or building societies, although in the current market these types of borrowing are less likely to be found. We do have the facility to borrow from the Public Works Loan Board (PWLB) which is part of the government and provides loans to local authorities.

44. The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investment returns. To be able to do this we would need to consider the cashflow requirements of the organisation to be able to maintain a sufficient flow of funds throughout the year by utilising short term investments to allow sufficient liquidity.

45. Currently our average rate of return on investments is approximately 0.5% and predicted to be approximately 1.2% for 2010/11. The current rates for borrowing for periods between 5 and 50 years are between 2.17% and 4.62%, therefore this shows you that there is a deficit between investment rates and borrowing rates. The Council has the option to use investments to internally fund capital expenditure, the consequence of this would be reduced interest earned, but this would be supplemented by the interest that would be charged to service areas for this provision of funds.

CONSULTATION ON CHANGES TO HOUSING SUBSIDY FINANCE

46. The government is expected to consult with local authorities on the removal of Housing Subsidy in February 2010. This is likely to require the HRA taking on a level of debt considered affordable by central Government. The timing of this and the amount of debt is very unclear.

Such a move would however have implications for the Treasury Management Strategy resulting in additional Local Authority debt to manage as well as the debt repayments and interest. The Treasury Management Strategy may need to be revised in year to accommodate the changes arising from any consultation and subsequent implementation.

PRUDENTIAL BORROWING

47. 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.

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

49. The Council intends to undertake prudential borrowing over the short and medium term, and any interest costs associated with this will be budgeted for. As potential schemes are put forward they will be assessed on an individual basis to ascertain their inclusion within the prudential borrowing programme.

50. Some examples of the types of schemes that the Council may wish to consider using prudential borrowing for are:
    - Office Accomodation;
    - Purchase of vehicles, to replace the previous leasing scheme
    - Improvement of Leisure facilities following transfer to a "not for profit" organisation
    - Building of new Council Houses
    - Replacement and refurbishment of play areas around the city

51. The prudential system provides a flexible framework approach 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.

52. Any prudential borrowing undertaken will affect the Councils prudential indicators, and when deciding on our levels of prudential borrowing the Council must have regard to:
    - Affordability eg: implications for Council Tax
    - Prudence and Sustainability eg: implications for external borrowing

- Value for money
- Stewardship of assets
- Service Objectives eg: strategic planning for the authority
- Practicality

53. 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.

54. Many local authorities have appraised potential prudential borrowing from within an 'invest to save' framework. This has allowed them to justify the capital expenditure by way of financing them from the revenue savings that they will make over the life of the project.

55. 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, eg: 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.

56. 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 ie: the revenue budget needs to be able to cover the interest and debt repayment of any borrowing any any 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.

57. 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.

58. The capital programme suggests that there are approximately £30m of capital schemes that need to be funded from prudential borrowing. This will tie up approx £2.7m in interest payments and repayment of borrowing per annum at its height. A ratio that we are required to

produce is the proportion of net revenue spend, this is calculated at 1.5%.

59. The considerations for the Council are listed below:

- The council has a stated policy in the Medium Term Financial Strategy (MTFS) to pay for assets as they are used through prudential borrowing or revenue contributions
- The council has a balanced 3 year budget but could be subject to a large funding squeeze (the worse case scenario in the MTFS) which means the pressure for reductions in revenue intensifies. Alternatively, despite the good track record in delivering savings, the council may struggle to deliver planned savings.

60. The council holds investment assets of £84m, against which the borrowing of £30m looks minimal. The Head of Corporate Assets holds a list of assets available for disposal. It the Council decided that it could no longer afford to meet the borrowing from revenue it could look to this list to obtain a capital receipt.

61. In summary, the use of Prudential Borrowing aligns with the council's other policies. There is a risk that the Council will struggle to repay the revenue costs in future years. This could be mitigated by earmarking the first £5m of capital receipts (after those required to fund commitments from 2010-2012) into a reserve to cover approximately 2 years of debt costs. This would be reviewed annually as part of this treasury strategy and the annual budget setting.

62. Council is recommended to increase the Operational borrowing limit to £30m but with the safeguard of earmarking the first £5m of uncommitted capital receipts into a reserve.

ESTABLISHING INVESTMENT STRATEGY 2010/11 – 2012/13

63. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:
    - It 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.
    - 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.

64. Expectations on shorter-term interest rates, on which investment decisions are based, shows a likelihood of the current 0.5% Bank Rate rising slowly through 09/10. The Council's investment decisions are

based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

65. Credit ratings remain the main independent market indicator of the financial strength of an organisation and are embedded in the current government guidance. However, the recent credit rating changes have impacted on counterparty lists drawn from the minimum credit rating criteria.

66. We are currently using a revised counterparty list that has recently been approved by CEB and Council, this includes the use of Money Market Funds, Debt Management Office and in addition the ability to invest with the eight banks and building societies that are back by UK Government.

67. Revised procedures are being put in place to allow the best investments to be undertaken on a daily basis, to ensure security of funds.

68. There is a clear operational difficulty arising from the current banking crisis. Ideally investments would be invested longer to secure better returns, however uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

69. The criteria for choosing counterparties set out below provides a sound approach to investment in 'normal' market circumstances. Whilst Members are asked to approve this base criteria, under the exceptional current market conditions the S151 Officer will temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to 'normal' conditions, or such time as the S151 Officer in conjunction with the Chief Executive and portfolio holder for finance decides to amend them. Similarly in the main the time periods for investments will be restricted to a maximum of 3 months., but we will do a full review of our cashflow to ensure that where possible we can obtain sound investments over longer periods of time

70. Options for increased security of funds include:
    - Debt Management Deposit Account Facility (DMADF – a government body which accepts local authority deposits)
    - Money Market Funds (MMF) deposit facilities rated AAA
    - Government Back financial institutions

Example rates for the above funds are as follows:

	Overnight rate %	1 month rate %	3 month rate %
DMO	0.25	0.25	0.25
MMF	0.46	NA	NA
Government Back financial institutions	NA	0.60	0.75

71. 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.

RISK BENCHMARKING

72. A development in the revised Codes and the CLG consultation paper is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature. More details of this approach are attached at Appendix C.

73. These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

74. Security – The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables is:

    - 0.20% historic risk of default when compared to the whole portfolio.

75. Liquidity – in respect of this area the Council seeks to maintain:

    - Bank overdraft - £2m
    - Liquid short term deposits of at least £20m available with a week's notice.
    - Weighted Average Life benchmark is expected to be no more than 1 year, with a maximum investment of 3 years.

76. Yield – Local measure of yield benchmarks are:

    - 7 day LIBID rate

CRITERIA FOR APPROVING COUNTERPARTIES

77. The primary principle governing the Council's investment criteria is the security of its investments, although the yield and return on the investment is also a key consideration. After this main principle the Council will ensure:
    - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections
    - It 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. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

78. The S151 Officer will maintain a counterparty list in compliance with the following criteria and will be reviewed on a regular basis. This will be submitted to Council for approval annually or as required. We are currently holding two list, one that details all those banks and building societies that meet our given criteria, and a condensed list that we are currently using on a daily basis. The latter includes a list of the eight institutions that are backed by the UK Government. This criteria is separate to that which chooses Specified and Non-Specified investments as it selects which counterparties the council will choose rather than defining what its investments are.

79. The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one of which meets the Council's criteria, and the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

80. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions

81. The criteria that we would use for providing a pool of high quality investment counterparties, in a time of a stable economic climate would be:

- Banks – Good Credit Quality - the council will use banks which are either UK banks or are non UK and domiciled in a country which has a minimum sovereign rating of AA, and as a minimum have the ratings below:
    - Fitch Short Term = F1
    - Fitch long Term = A-
    - Moody's Short Term = P-1
    - Moody's Long Term = A3
    - S&P's Short Term = A1
    - S&P's Long Term = A-
    - Individual/Financial Strength = C
    - Support = 3

  In addition to this the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

    a) Wholesale deposits in the bank are covered by a government guarantee
    b) The government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and
    c) The Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee
    d) The Council's house bank – Co-operative- if this falls below the above criteria, balances will be minimised in both monetary size and time

  Also Eligible institutions, there are the organisations that are within the HM Treasury Credit Guarantee Scheme, these instituitions have been subject to suitability checks and have access to HM Treasury liquidity if needed.

- Building Societies – the Council will use all societies with assets in excess of £0.5billion
- Bank Subsidiary and Treasury Operations – the Council will use these where the parent bank has the necessary ratings outlined above.
- Money Market Funds = AAA
- UK Government - including gilts and the DMADF
- Local Authorities, Parish Councils etc
- Supranational institutions

The time limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch	Moody's	Standard & Poors	Money Limit	Time Limit
Banks & Building Societies					
Upper Limit Category	*F1+/AA-*	P-1/Aa3	A1+/AA-	£10.0m	>364 days
Middle Limit Category	F1/A-	P-1/A3	A-1/A-	£7.0m	<365 days
Unrated Building Societies					
Lower Limit Category	Asset base between 0.5bn and 2bn			£4.0m	183 days
Upper Limit Category	Asset base greater than 2bn			£7.0	< 365 days
Other					
Money Market Funds	-	-	-	£15.0m	364 days
DMO				Unlimited	364 days
Local Authorities				£10.0m	364 days

82. Limits have also been placed on countries and sectors, these are:
    - No more than 20% with any one counterparty
    - No limit for UK investments
    - Maximum 10% of total investments to be with Irish Institution
    - Maximum 10% of total investments to be with institutions in other countries

83. Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operations market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information, for example Credit Default Swaps, negative rating watches and outlooks, will be applied to compare the relative security of differing investment counterparties.

84. Due to the uncertainty in the financial markets it is recommended that the Investment Strategy is approved on a similar approach to previous years which will provide officers with the flexibility to deal with any unexpected occurrences. Officers will restrict the pool of available counterparties from this criteria to safer instruments and institutions.

85. Currently this involves the use of DMADF, AAA rated Money Market Funds and Eligible Institutions which are provided support from the Government. Investments are also currently only being carried out for short fixed periods to also improve the security of investments.

86. The Council's house bank is the Co-operative Bank. The credit ratings for this bank do not currently meet the criteria set above. Therefore we are only using 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.

87. In the normal course of the Council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short-term investments.

88. 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. Currently the Council is not undertaking any long term investments due to the uncertainty of the economy and to reduce the risk of any losses.

89. 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.

90. The current counterparty list and the full counterparty list are attached as Appendix B for information and approval.

91. The proposed criteria for Specified and Non-Specified investments are shown in Appendix D for approval.

92. The expected movement in interest rates

UPDATE ON CURRENT ECONOMY

Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates*		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.6	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

* Borrowing Rates

93. Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced but it will remain insipid and there is a danger that early reversal of monetary ease, rate

cuts and Quantative Easing (QE), could trigger a dip back to negative growth and a W shaped GDP path.

94. Credit extension to the corporate and personal sectors has improved modestly but banks remain nervous about the viability of counterparties. This is likely to remain a drag upon activity prospects, as will the lacklustre growth of broad money supply.

95. The main drag upon the economy is expected to be weak consumers' expenditure growth. The combination of the desire to reduce the level of personal debt and job uncertainty is likely to weigh heavily upon spending, This will be amplified by the prospective increased in taxation already scheduled for 2010 – VAT and National Insurance. Without a rebound in the key element of UK GDP growth recovery in the economy is set to be weak and protracted.

96. The MPC will continue to promote easy credit conditions via QE. QE has been extended to a total of £200bn and there is still an outside chance that it could be expanded further in February. Whether this has much impact in the near term remains a moot point given the personal sector's reluctance to take on more debt and add to its already unhealthy balance sheet.

97. With inflation set to remain subdued in the next few years, the pressure upon the MPC to hike rates will remain moderate. But some increase will be seen as necessary in 2010 to counter the effects of external cost pressures, as commodity prices begin to rise again, and to avoid damage that sterling could endure if the UK is seen to defy an international move to commence policy exit strategies.

98. Longer term rates are expected to be more volatile. The current softness of gilt yields & PWLB rates may continue for a while yet, given that these are being driven by a benign international backdrop, and the effects of QE. Nevertheless this process will come to an end before the close of the financial year.

99. This is likely to herald a return to rising yields for a number of reasons:

- Net guild issuance will rise sharply;
- This will be increased by the extent to which the BoE attempts to claw back funds injected to the economy via the QE programme;
- Investors will be looking to place more of their funds in alternative instruments as their risk appetite increases, demand for gilts will weaken as a consequence;
- A decision to leave QE in place will generate inflation concerns and pressurise long yields higher.

SENSITIVITY TO INTEREST RATE MOVEMENTS

100. Future Council Statement of Accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to treasury management costs/income for next year. For debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

£	**2009/10 Estimated +1%**	**2009/10 Estimated –1%**
Revenue Budgets		
Interest on Borrowing	0	0
HRA interest on balances	-40,000	40,000
HRA Item 8 interest	35,000	-35,000
Investment Income	125,000	-125,000

PRUDENTIAL INDICATORS

101. 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:

102. **Estimates of Capital Expenditure**, split between GF and HRA, this is based on the current capital programme.

	2009/10 Original Estimate £000's	**2009/10 Revised Estimate £000's**	**2010/11 Estimate £000's**	**2011/12 Estimate £000's**	**2012/13 Estimate £000's**
General Fund	12,985	12,790	14,653	11,162	8.719
HRA	11,463	15,027	21,732	9,168	6,865

103. **Actual and Estimate of the ratio of financing costs to the net revenue stream**, this identifies the trend in the cost of capital against the net revenue stream and show GF and HRA separately.

General Fund	2009/10 Original Estimate £000's	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Interest Costs	1,162.78	666.53	1,038.81	1,165.03	1,135.37
Investment income	-798.12	-245.80	-360.47	-531.28	-1,007.95
Net financing cost	364.66	420.73	678.34	633.75	127.42
Revenue stream	28,958.00	28,958.00	28,958.00	28,958.00	28,958.00
Ratio	1.3%	1.5%	2.3%	2.2%	0.4%

Housing Revenue Account	2009/10 Original Estimate £000's	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Item 8 interest	1,004.97	984.35	1,025.18	1,039.95	1,039.95
Investment income	-142.00	-200.00	-200.00	-285.00	-285.00
Net financing cost	862.97	784.35	825.18	754.95	754.95
Revenue stream	14,979.98	14,979.98	14,979.98	14,979.98	14,979.98
Ratio	5.8%	5.2%	5.5%	5.0%	5.0%

104. **Estimate of the incremental impact of capital investment decisions on the Council Tax**, this shows the impact of any decisions that are made on investment through the capital programme and how this will ultimately affect the Basic Band D Council Tax.

105. The figures in the table below have been calculated by looking at those schemes that are currently uncommitted on the current capital programme and looking at the impact they will have on Council Tax. The figures in the table show the impact this spend will have on the full year Band D basic amount of Council Tax.

106. The first line of the table shows the gross impact of those capital schemes, but the Council intends to cover this funding by the sale of assets, or revenue contributions and the use of future capital receipts, therefore **this would have a nil impact on the Council Tax**, which is shown in the table.

107. The Council will not enter into any uncommitted capital scheme until the sale of assets is confirmed, therefore not allowing this capital spend to have an impact on Council Tax. The pot of brought forward capital receipts is currently being treated more generally, and therefore the split between HRA and GF is more flexible through the period of

reduced receipts. However the council decision to earmark capital receipts to each fund remains in place.

108. In summary if the Council were to spend £1million on a new capital project without asset sales to finance it, this could potentially impact on Basic Band D Council Tax by £0.82.

	2009/10 Original Estimate £	2009/10 Revised Estimate £	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
Capital spend impact on Council Tax Band D	2.53	2.53	4.58	4.70	3.50
Capital receipts impact on Council Tax Band D	-2.53	-2.53	-4.58	-4.70	-3.50
Overall net impact on Council Tax Band D	0.00	0.00	0.00	0.00	0.00

109. **Estimate of the incremental impact of capital investment decision on housing rents**, this shows the impact any decisions made on our capital investments will have on our weekly housing rents.

110. The figures in the table below have been calculated by looking at those schemes that are currently on the capital programme with funding resources coming from the revenue account, and looking at the impact this will have on the weekly housing rents.

111. The first line of the table shows the gross impact of those capital schemes, but the Council also intends to cover this funding by the sale of assets, revenue contributions and the use of available capital receipts, therefore **this would have a nil impact on the Weekly housing rents**, which is shown in the table.

112. The Council will not enter into any uncommitted capital scheme until the sale of assets is confirmed, therefore not allowing this capital spend to have an impact on the housing rents.

113. The key driver for setting our housing rents is the rent formula from Central Government, capital spend should not affect the rent we charge, therefore the net impact of capital spend will be zero.

114. For every £1 million that the Council spends on new capital projects without asset sales to finance it will have an impact of £0.09 per week on rents.

	2009/10 Original Estimate £	2009/10 Revised Estimate £	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
Capital spend impact on Weekly Housing Rents	0	0.00	0.03	0.04	0.04
Capital receipts impact on Weekly Housing Rents	0	0.00	-0.03	-0.04	-0.04
Overall net impact on Weekly Housing Rents	0.00	0.00	0.00	0.00	0.00

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

116. **Estimate of capital financing requirement (CFR**), this is the total outstanding capital expenditure that has not yet been paid for from either capital or revenue resources. It is essentially a measure of the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.

	2008/09 Actual £000's	2009/10 Original Estimate £000's	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Housing	18,190	18,190	18,736	19,282	21,584	23,887
Non Housing	-7,637	-5,454	-2,911	8,280	15,454	18,229
Total	**10,553**	**12,736**	**15,825**	**27,562**	**37,038**	**42,116**

117. **Authorised limit for external debt**, this represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full 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.

	2009/10 Original Estimate £000's	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Borrowing	17,000	10,000	24,000	33,500	39,500
Other Long Term Liabili	1,900	1,900	1,700	1,500	1,500
Total	18,900	11,900	25,700	35,000	41,000

118. **Operational boundary for external debt,** 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.

	2009/10 Original Estimate £000's	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Borrowing	14,000	8,000	22,500	32,000	38,000
Other Long Term Liabili	1,900	1,900	1,700	1,500	1,500
Total	15,900	9,900	24,200	33,500	39,500

119. **Net Borrowing v Capital Financing Requirement (CFR),** 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 2008/09 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

	2009/10 Revised Estimate £000's	2010/11 Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's
Total Debt 31 March	7,180	17,038	26,077	29,540
Investments	42,417	44,340	41,528	41,756
Net Borrowing	-35,237	-27,302	-15,451	-12,216
CFR	15,825	27,562	37,038	42,116

120. **Compliance with the CIPFA Code of Practice for Treasury Management in the Public Sector**, the Council can confirm that it has complied with this code throughout 2009/10.

121. **Upper limit on fixed and variable interest rate borrowing and investments,** 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.

	2009/10 Original Estimate %	2009/10 Revised Estimate %	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %
Limit on fixed rate borrowing	100	100	100	100	100
Limit on variable rate borrowing	25	25	50	50	50
Limit on fixed rate investments	100	100	100	100	100
Limit on variable rate investments	50	50	50	50	50

122. **Upper and Lower limit for the maturity structure of borrowing,** these are used to reduce the Council's exposure to large fixed rate sums falling due for repayment at the same time.

	2009/20 Revised Estimate Upper %	2009/10 Revised Estimate Lower %	2010/11 Estimate Upper %	2010/11 Estimate Lower %	2011/12 Estimate Upper %	2011/12 Estimate Lower %	2012/13 Estimate Upper %	2012/13 Estimate Lower %
Under 12 months	30	0	30	0	30	0	30	0
12 months to 2 yrs	30	0	30	0	30	0	30	0
2 yrs to 5 yrs	50	0	80	0	80	0	80	0
5 yrs to 10 yrs	100	0	50	0	50	0	50	0
10 yrs and above	100	0	50	0	50	0	50	0

123. 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.

	2008/09 Original Estimate £m	2008/09 Revised Estimate £m	2009/10 Estimate %	2010/11 Estimate %	2011/12 Estimate %
Investments for periods longer than 364 days	8	0	10	10	10

TREASURY MANAGEMENT ADVISORS

124. The Council currently has a contract for its Treasury Management advisory service with Butlers. This contract includes:

- Technical support on treasury matters, capital finance issues and assistance with member reports
- Economic and interest rate analysis
- Debt services which includes advice on the timing of borrowing
- Generic investment advice on interest rates, timing and investment instruments
- Credit rating and market information on interest rates, timing and investment instruments

125. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council.

126. This contract was initially for 3 years and this period ended in November 2009, the contract has been extended until 31st March 2009, whilst we re-tender.

127. The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. The Council is starting to put into place a number of opportunities to ensure adequate training takes place, some of these are:

- Member workshops
- Officer training with our advisors and CIPFA

RECOMMENDATIONS

128. The City Executive Board is asked to recommend to Council to:

1) Adopt and approve the Prudential Indicators and limits for 2010/11 to 2012/13 contained within this report
2) Approve the Minimum Revenue Provision (MRP) statement contained within the report which sets out the Council's policy on MRP
3) Approve the Treasury Management Strategy 2010/11 to 2012/13, and the treasury prudential indicators
4) Approve the Investment Strategy 2010/101contained in the treasury management strategy, and the detailed criteria
5) Approve the Counterparty List as attached at appendix B.
6) The revision of the Council's financial regulations at Appendix A. this revision nominates Value and Performance Scrutiny Committee to ensure effective scrutiny of the Treasury Management Strategy and policies. This is an accounting instruction that sits underneath the finance rules within the constitution.
7) To increase the affordable borrowing limit to £38m but with the safeguard of earmarking the first £5m of uncommitted capital receipts into a reserve to provide a fund from which repayments to this borrowing can be made in exceptional circumstance

which mean that these can not be met by revenue savings in the short term.

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