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OXFORD CITY COUNCIL

To: City Executive Board
Council

Date: 9th and 21st February 2011 **Item No: 6**

Report of: Corporate Director Finance and Efficiency

Title of Report: TREASURY MANAGEMENT STRATEGY 2011/12

Summary and Recommendations

Purpose of report:
To present the Treasury Management Strategy 2011/12 and the Prudential Indicators for 2011/12 – 2014/15 for comment and approval

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 Prudential Indicators and limits for 2011/12 to 2014/15 as set out in sections 71 -96 below.
2. Approve the Minimum Revenue Provision (MRP) statement at paragraphs 13 - 16 which sets out the Council's policy on repayment of debt.
3. Approve the Treasury Management Strategy 2011/12, and the treasury prudential indicators at paragraphs 18 – 46
4. Approve the Investment Strategy 2011/12 contained in the treasury management strategy, and the detailed investment criteria as set out in paragraphs 47 – 67, and appendix 2 and 3.

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

Executive Summary

1. The Treasury Management Strategy for 2011/12 has been written in accordance with the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The no significant changes to our strategy. However, our Treasury Management Advisors changed in year, and are now Sector. This has led to a change in our counterparty approval methodology.

2. The report presents the Council's prudential indicators for 2011/12 – 2014/15. Notable indicators include capital spend and borrowing limits, as these are areas where the biggest activity is shown.

3. Members should note the Minimum Revenue Provision (MRP policy included in paragraph 13-16

4. The Council has investments of between £35m 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 the 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 external debt was £5.056m at 1st April 2010, repayments made during the year have reduced the figure to £4.78m. 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 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. The Council's capital programme will be funded from a combination of government grants, capital receipts, S106 funding, prudential borrowing and revenue resources. Prudential borrowing costs are factored into revenue budgets.

Introduction and Background

7. Treasury Management is defined 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.

8. The Local Government Act 2003 (the Act) and supporting regulations requires 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.

9. 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

10. The Department of Communities and Local Government issued revised investment guidance which came into effect from 1st April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009 which was adopted by this Council on 3rd February 2010.

11. The primary requirements of the 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: Value and Performance Scrutiny Finance Panel.

12. 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 4 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. Additional quarterly performance reporting is now also produced for Value & Performance Scrutiny.

Minimum Revenue Provision (MRP) Statement 2011/12

13. The council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09*,* and will assess its MRP for 2011/12 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.

14. The major proportion of the MRP for 2011/12 will relate to the more 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 2010 will be subject to MRP under option 3, which will be 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 related to the estimated life of that building.

15. 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.

16. As some types of capital expenditure incurred by the Council are not attributable to an individual asset, asset lives will therefore be assessed on a basis which most 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.

Legal Implications

17. 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

- 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.

Treasury Management Strategy

Interest Rates

18. Interest rates are important to the City Council as we have between £35 million and £40 million of funds as fixed term deposits at any one time (the amount varies during the year). Our deposits are made at or close to prevailing interest rates.

19. Interest rates are currently at an all time low, with Base Rate at 0.5%. It has been at this level since March 2009 and is forecast to remain at this level until November 2011 and then begin rising steadily..

Sector Bank Rate forecast for financial year ends (March)

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

20. 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.

21. The Council will avoid locking into longer term deals 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 – 2013/14

22. The Council had approx £5m of external debt as at 1st April 2010, 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.

23. During 2010/11 repayments will reduce debt outstanding to £4.38m at the end of March 2011.

24. The Council also has £1.6m 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 £1.4m by the end of March 2011.

25. The Capital Financing Requirement (CFR) as at 1st April 2010 is £14.2m which is above our current level of external borrowing. This is an indication of the Council's overall underlying need to borrow to fund its capital investments

26. As at the 31st March 2011 our CFR is expected to be £22.5m and our external borrowing at £4.38m. This indicates a need to borrow on the external market in the medium term, if all schemes on the current capital programme go ahead.

27. 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 with the need to watch out for long term interest rate increases.

28. 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 where a sharp rise in interest rates is expected and therefore borrowing costs would have increased 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.

29. In determining whether borrowing will be undertaken in advance of need the Council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- 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.

30. 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.

31. The option of postponing borrowing and running down investment balances will also be considered, this is known as internal borrowing. 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.

32. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years.

33. Currently our average rate of return on investments is approximately 0.5% and predicted to be approximately 1.0% for 2010/11. The current rates for borrowing for periods between 5 and 50 years are between 3% and 5.1%, therefore there is a deficit between deposit rates and borrowing rates.

34. In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Council officers, in conjunction with our treasury advisors, Sector, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

    - 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.

35. On 20th October 2010, the Treasury gave instructions whereby the PWLB was required to raise all PWLB rates by increasing the margin over gilt yields for all maturity periods to 1%. Prior to this, the margin was generally about 15 bps for most periods except the very long ones where the margin was about 25 bps. This has, therefore, made PWLB borrowing less competitive when compared to Lenders Option Borrowers Option borrowing or borrowing from the market. It is currently uncertain whether banks would be both willing and able to supply the sheer size of the total demand for borrowing previously met by the PWLB.

Consultation on changes to Housing Subsidy Finance

36. 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 the amount of debt and associated cost is very unclear. Such a move will 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

37. 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.

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

39. The Council intends to undertake prudential borrowing to fund schemes in the capital programme. The Council's budget for 2011-12 includes prudential borrowing of £8m for cyclical vehicle fleet replacements and for the Leisure Competition Pool. Associated interest and repayment costs are included in the budget.

40. 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.

41. 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

42. 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.

43. 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.

44. 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.

45. 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.

46. The Capital programme includes approximately £24m of capital schemes that need to be funded from prudential borrowing during the period

2010/11 through to 2014/15. This will tie up approx £3.2m in interest payments and repayment of borrowing per annum at its height.

Investment Strategy 2011/12 – 2014/15

47. The primary principle governing the Council's investment criteria 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.

48. Investment instruments identified for use in the financial year are listed in Appendix 2 under the Specified and Non-Specified investment categories. Counterparty limits will be set through the Council's Treasury Management Practices (TMP's).

Creditworthiness policy

49. The Council uses the creditworthiness service provided by Sector. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. 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

50. 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 for 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.

51. 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
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months

52. CIPFA recommend using the lowest rating from all three rating agencies, the Sector creditworthiness service uses a risk weighted scoring system, rather than the lowest rating for each agency, this provides a more balanced view of the ratings.

53. 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.
- 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.

54. 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 ratings of that government support to inform its investment decisions.

55. 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 3.

56. The S151 Officer will maintain a counterparty list in compliance with the criteria 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.

57. 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.

58. In addition to counterparties meeting the Sector creditworthiness criteria the Council will also place deposits with the top five Building Societies by asset base. Whilst judging building societies by asset size is not 'fool proof' it is a measure that is widely used, especially by the Council's previous Treasury Management advisors. Members should be aware that the council's current advisors are not in favour of unrated building societies due to the volatility of the sector. Officers believe that the structure of building societies as mutuals and their governance arrangements being different to banks will provide security of our investments

59. Officers consider even under the current financial climate which has improved since the Icelandic crisis the asset base sizes quoted above are too low. It is therefore recommended that only Building Societies with an asset base of £9bn or above are added to the counterparty list and that a restriction of 3 months is applied to the term of investment. An additional restriction of no more than 20% of the portfolio being placed in these non-specified investments and a maximum limit of £3m with any one counterparty is also applied.

60. There are currently five Building Societies (one of which is the Nationwide which we currently invest with) which would fall into the category of an asset base of over £9bn which are shown below:

Building Society	**Asset Base**	**Fitch Credit Rating**
Nationwide	£190,497m	F1+/AA-
Yorkshire	£25,194m	F2/A-
Coventry	£21,037m	F1/A
Skipton	£15,859m	F2/A-
Leeds	£9,556m	F1/A

61. The Clydesdale Bank is a counterparty which meets the Council's minimum criteria with credit ratings of F1+/AA-, P-1/A1, A-1/A+ and although owned by National Bank of Australia has a wholly owned UK subsidiary. It is therefore recommended that the Clydesdale bank is added to the Council's unrestricted list of financial institutions. Current investment returns are around 0.75% which is 0.50% higher than DMO. Sector are comfortable with the suggestion for the use of this bank.

62. 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 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, these are explain below and in appendix 2 you need to explain what these are will be utilised for the control of liquidity as both categories allow for short-term investments.

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.

67. The proposed criteria for Specified and Non-Specified investments are set out in Appendix 2.

Economic Background

Sector's forward view

68. It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector, our advisors, has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:
    - the speed of economic recovery in our major trading partners - the US and EU
    - the danger of currency war and resort to protectionism and tariff barriers if China does not address the issue of its huge trade surplus due to its undervalued currency
    - the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
    - changes in the consumer savings ratio
    - the speed of rebalancing of the UK economy towards exporting and substituting imports
    - the potential for more quantitative easing, and the timing of this in both the UK and US, and its subsequent reversal
    - the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
    - the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

69. The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

70. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

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. A certain level of capital expenditure is grant funded. The revenue consequences of this spend will need to be covered from the Council's own resources.

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.

73. 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 i.e anticipated asset sales may be postponed or reduced due to the property market or planning issues.

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

	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
General Fund	14,653.0	13,097.6	20,277.5	5,927.0	5,730.0	4,545.0
HRA	21,732.0	17,859.0	8,500.0	7,750.0	7,750.0	7,750.0
TOTAL	36,385.0	30,956.6	28,777.5	13,677.0	13,480.0	12,295.0

B. Capital Financing Requirement (CFR).

75. 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:

	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Housing	19,282	19,169	19,715	24,315	24,315	24,315
Non-housing	8,280	2,508	13,166	9,590	11,041	12,437
	27,562	21,677	32,881	33,905	35,356	36,752

76. 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

77. 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.

General Fund	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Interest Costs	1,038.81	763.03	486.30	415.68	323.56	209.06
Investment income	-360.47	-228.50	-293.13	-597.19	-963.75	-963.75
Net financing cost	678.34	534.53	193.18	-181.51	-640.19	-754.70
Revenue stream	27,885.72	27,885.72	28,958.00	28,958.00	28,958.00	28,959.00
Ratio	2.4%	1.9%	0.7%	-0.6%	-2.2%	-2.6%

Housing Revenue Account	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Item 8 interest	1,039.95	701.97	800.69	960.69	960.69	960.69
Investment income	-285.00	-33.14	-56.42	-113.55	-192.11	-192.11
Net financing cost	754.95	668.83	744.28	847.14	768.58	768.58
Revenue stream	14,979.98	14,979.98	14,979.98	14,979.98	14,979.98	14,979.98
Ratio	5.0%	4.5%	5.0%	5.7%	5.1%	5.1%

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

78. 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 affect the Basic Band D Council Tax.

79. 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.

80. 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.

81. 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.

82. 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.

	2010/11 Original Estimate £	2010/11 Revised Estimate £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Capital Spend impact on Council Tax Band D	4.58	15.33	16.11	5.36	5.52	4.38
Capital Receipts impact on Council Tax Band D	-4.58	-15.33	-16.11	-5.36	-5.52	-4.38
Overall net impact on Council Tax Band D	0.00	0.00	0.00	0.00	0.00	0.00

83. The estimate of the incremental impact of capital investment decision on housing rents is shown below, this shows the impact any decisions made on our capital investments will have on our weekly housing rents.

84. 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.

85. 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.

86. 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.

87. 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.

88. 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.

	2010/11 Original Estimate £	2010/11 Revised Estimate £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Capital Spend impact on Weekly Housing Rents	0.03	1.93	0.92	0.84	0.84	0.84
Capital Receipts impact on Weekly Housing Rents	-0.03	-1.93	-0.92	-0.84	-0.84	-0.84
Overall net impact on Weekly Housing Rents	0.00	0.00	0.00	0.00	0.00	0.00

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

E. Authorised limit for external debt

90. 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.

	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Borrowing	24,000	25,000	36,000	39,500	39,500	41,000
Other Long Term Liabil	1,700	1,700	1,500	1,500	1,500	1,500
Total	25,700	26,700	37,500	41,000	41,000	42,500

F. Operational boundary for external debt

91. 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.

	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Borrowing	22,500	23,000	35,000	37,000	38,000	39,000
Other Long Term Liabil	1,700	1,700	1,500	1,500	1,500	1,500
Total	24,200	24,700	36,500	38,500	39,500	40,500

G. Net Borrowing v CFR

92. 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.

	2010/11 Original Estimate £000's	2010/11 Revised Estimate £000's	2011/12 Estimate £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's
Total Debt 31 March	11,109	11,888	6,659	6,078	4,925	2,322
Investments	34,954	35,000	35,000	35,000	35,000	30,000
Net Borrowing	-23,845	-23,112	-28,341	-28,922	-30,075	-27,678
CFR	35,356	21,677	32,881	33,905	35,356	36,752
Net Borrowing v CFR	**59,201**	**44,789**	**61,222**	**62,827**	**65,431**	**64,430**

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

93. The Council can confirm that it has complied with this code throughout 2009/10.

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

94. 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.

	2010/11 Original Estimate %	2010/11 Original Estimate %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 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
Lower limit on fixed rate borrowing	25	25	25	25	25	25
Lower limit on fixed rate investments	20	20	20	20	20	20

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

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

	2010/11 Estimate Upper %	2010/11 Estimate Lower %	2011/12 Estimate Upper %	2011/12 Estimate Lower %	2012/13 Estimate Upper %	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	30	0	30	0	30	0
12 months to 2 years	30	0	30	0	30	0	30	0	30	0
2 years to 5 years	80	0	80	0	80	0	80	0	80	0
5 years to 10 years	50	0	50	0	50	0	50	0	50	0
10 year and above	50	0	50	0	50	0	50	0	50	0

96. 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.

	2010/11 Original Estimate %	2010/11 Revised Estimate %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 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:
Version number:1

Appendix 2

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	90 days
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 3

AAA

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

AA+

- Australia
- Belgium
- Spain *

AA

- Hong Kong
- Japan
- Kuwait
- Qatar (AA S&P rating)
- UAE

AA-

- Italy
- Portugal *
- Saudi Arabia

* Sector has suggested that clients exercise care and caution when considering placing deposits with Portuguese and Spanish banks as their economies are currently under severe pressure.

Ireland no longer appears on this list as it has been downgraded to A+.