Meeting:	Cabinet
Date:	14 February 2008
Subject:	Treasury Management Strategy 2008-2009 and Prudential Indicators 2008-2009 to 2010-2011
Key Decision:	Yes
Responsible Officer:	Myfanwy Barrett (Corporate Director - Finance)
Portfolio Holder:	Councillor David Ashton (Portfolio Holder for Finance and Portfolio Co-ordination)
Exempt:	No **Except appendix 2** Under the provision of Schedule 12A to the Local Government Act 1972, this report is considered to contain confidential information under Part 1, Paragraph 3, in that it contains information relating to the financial or business affairs of a particular person i.e. Company, other than the Council.
Enclosures:	Appendix 1: Specified & Non-Specified Investments Appendix 2: Borrowers and lending limits Appendix 3: Current structure of lending Appendix 4: Current structure of long-term borrowing

SECTION 1: SUMMARY AND RECOMMENDATIONS

This report sets out the Council's Treasury Management Strategy for 2008-2009 and the levels at which the Prudential indicators should be set for the financial years 2008-2009 to 2010-2011.

RECOMMENDATIONS:

The Cabinet is requested to:

1. Recommend to Council the approval of the Treasury Management Strategy for 2008-2009 set out in paragraphs 5 to 17;
2. Recommend to Council the approval of the Prudential Indicators for 2008-2009 to 2010-2011 set out in paragraphs 18 to 39 and
3. Approve the Council's lending list as set out in appendix 2;

REASON:

To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and other relevant guidance.

SECTION 2: REPORT

Introduction

1. The Council is required, under the Local Government Act 2003, to approve a Treasury Management Strategy each year. The proposed strategy for 2008-2009 is based on the following principles:

    - The Council will comply with DCLG guidance on local government investments.
    - The Council will comply with the CIPFA Code of Practice for Treasury Management.
    - The Council delegates responsibility for the implementation and monitoring of its treasury management policy to Cabinet and for the execution and administration of treasury management decisions to the Council's Section 151 Officer.
    - Priority when making investments will be given to security and liquidity rather than yield – however yield will not be ignored; it is reasonable to seek the higher rate of interest, though this needs to be consistent with proper levels of security and liquidity.
    - The Council's investments will be made largely by way of fixed rate deposits with leading financial institutions and local authorities. There will be a wide spread of placements in order to minimize exposure to risk.
    - The Council will continue to use money market funds.
    - In compiling forecasts for investment income, a prudent view will be taken of interest rates.
    - Borrowing will be managed with a view to achieving a competitive interest rate and appropriate maturity profile.
    - New borrowing will be taken out to finance capital expenditure in line with the approved capital programme and Prudential Indicators.
    - All transactions carried out via the London Wholesale Money Market will be governed by the Bank of England's Non-Investment Product Code.

2. In addition the Council is required to approve a number of Prudential Indicators for 2008-2009 to 2010-2011. The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability. To demonstrate that local authorities have fulfilled these objectives the code sets out the indicators that must be used and the factors that must be taken into account.

3. The Prudential Indicators relate to:
    - The level of capital expenditure
    - Ratio of capital financing costs to net revenue stream
    - Incremental impact of capital investment on Council Tax and rents
    - Authorised limit and operational boundaries for borrowing
    - Net borrowing and the capital financing requirement
    - Compliance with CIPFA's treasury management code of practice
    - Interest rate exposure
    - Maturity structure of borrowing
    - Total principal sums invested for more than 364 days

Treasury Management Strategy

4. The Council complies with the DCLG guidance on local government investments as outlined in Appendix 1. The proposed lending list, which includes some additional borrowers, attached at Appendix 2 is recommend for approval.

5. The Council complies with CIPFA's Treasury Management Code of Practice.

6. Cabinet is reminded that the Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Cabinet and for the execution and administration of treasury management decisions to the Council's Section 151 Officer. This role is the Chief Finance Officer, currently the Corporate Director of Finance, who acts in accordance with the Council's Treasury Management policy statement and Treasury Management Practices and if, he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

Investment

7. The Council's lending policies emphasise security of funds in a volatile and uncertain market largely by way of fixed rate deposits with leading financial institutions and local authorities. The level of deposits with any one institution is capped to ensure a wide spread of placements in order to minimise exposure to risk. A list of borrowers together with lending limits and the 'Fitch' credit ratings is attached at Appendix 2. Fitch Ratings Ltd is one of the leading international credit rating agencies. Possible deposits are spread through the coming year to ensure that advantage can be taken of any unexpected increase in interest rates, whilst avoiding a large exposure to equally sudden falls. Appendix 3 shows the current profile of lending, including investments of more than 364 days.

8. When deciding the duration of day-to-day deposits both cash flow requirements and future interest rate movements have to be taken into consideration. The UK base rate is currently 5.50%, however the economic situation in the UK and globally can change rapidly. The Bank of England has indicated that there could be further base rate reductions in 2008. This means that strategy must be flexible, in order to take advantage of any unexpected movements in the market. Basing strategy on market forecasts at one point in the year can leave the Council open to reduced returns as circumstances change.

Money Market Funds and Deposit Account

9. As from 1 April 2002 local authorities were able to invest in Money Market Funds. These are mutual funds that have the advantage of offering a standard rate of interest regardless of the size of deposit. The Council has accounts with five Money Market Funds and also operates a deposit account with the Bank of Scotland on which interest is paid at base rate. These accounts are used as part of the strategy to optimize returns on monies held for short periods of time and it is proposed that their use is continued.

External Cash Managers

10. Scottish Widows Investment Partnership (SWIP) was appointed in 2004 to manage a cash fund of £30m (£34.9m as at January 2008).

11. SWIP were set a target of outperforming the 7day LIBID rate (compounded weekly) by 115% over a rolling 3-year period. Up to 100% of the fund can be invested in UK Government Securities and the maximum permitted weighted average duration of the portfolio is 5 years. This approach to the external funds gives the manager the opportunity to maximize returns by taking full advantage of longer term investments, if they believe this to be the correct course of action. The higher risk of this strategy is counterbalanced by all the monies managed internally being held in shorter-term cash investments.

12. Officers meet with the cash manager on a regular basis to discuss their performance, however, performance to date remains disappointing against requirements. Officers have taken advice from Sector Management, the Council's external treasury advisor, on terminating this contract and bringing the portfolio back in-house from next year.

Estimated income from investments

13. The revenue budget for 2008-2009 assumes that interest rates over the year will be 4.75% on average, giving a total interest received of £4.9m based on an average investment of £105m. Predictions from economists for interest rates at the end of 2008 currently vary from 4.50% up to 4.75%. Base rate, now 5.5%, is expected to reduce to 5.25% by the end of 2007-2008, with a possible two further reductions in 2008-2009. Close monitoring will be maintained of investment receipts as part of the Treasury Management strategy. Investments are made with the aim of safeguarding the Council's budget position and the security of the investment, whilst always attempting to optimise the return on investments.

Debt Management and Borrowing

14. The Council's borrowing requirement for 2007-2008 is derived from the capital programme. It is not possible to say at this time exactly how this requirement will be met as flexibility needs to be maintained to use the most appropriate form of funding available. The estimated borrowing for the capital programme is set out below:

	£000	
2007-2008	30,810	Probable
2008-2009	27,490	Estimate
2009-2010	23,610	Estimate
2010-2011	20,800	Estimate

15. With advice from Sector in May 2007 the Council carried out restructuring of PWLB loans by repaying various expensive loans of £98m and renewing with new loans of £60m at a lower fixed rate of 4.60% per annum over an average loan period of 46 years. This exercise resulted in a net saving of £10.19m, which is to be spread over ten years to comply with accounting standards. In December 2007, again with Sector advice, the Council repaid £20.8m PWLB variable rate loan of 6% per annum and replaced with a 70 years loan (5 year fixed LOBO) of £20.8m with Dexia Bank at 4.20% per annum until December 2012 and thereafter at 4.20% per annum, subject to lenders option. This exercise has generated further net annual savings of £0.268m for the next

five years. Currently the Council holds long-term PWLB debt of £120.59m (£179.5 as at January 2007) and debt with other Banks of £73.8m (£63m as at January 2007), totaling £194.39m (£242.5 as at January 2007).

16. Appendix 4 shows a graph of the current structure and maturity profile of the Council's Long Term Debt Portfolio.

Prudential Indicators

17. The Prudential Code for Capital Finance came into effect from 1 April 2004. The key objectives of the Code are to ensure that the capital investment plans of local authorities are affordable, prudent, sustainable, and follow good practice.

18. To demonstrate that each authority fulfils these objectives the Code sets out a number of indicators and factors that must be considered. Set out below are the indicators that must be approved at the same time that the Council's revenue and capital budgets are set.

Capital Expenditure

19. The actual capital expenditure incurred in 2006-2007 and the current estimate of gross capital expenditure to be incurred for the current and future years are summarised below. The detailed capital programme is reported elsewhere on the Cabinet's agenda.

	2006-07	2007-08	2008-09	2009-10	2010-11
	£000	£000	£000	£000	£000
	Actual	Estimate	Estimate	Estimate	Estimate
Non-HRA (gross)	55,412	54,007	59,892	52,762	38,783
Non HRA (net)	**45,428**	**27,616**	**36,180**	**34,865**	**29,380**
HRA (gross)	6,364	13,577	12,500	10,500	6,000
HRA (net)	**2,831**	**9,980**	**8,804**	**6,704**	**2,101**
Total Gross	61,776	67,584	72,392	63,262	44,783
Total (net)	**48,259**	**37,596**	**44,984**	**41,569**	**31,481**

Ratio of Financing Costs to Net Revenue Stream

20. The financing costs of the Council include interest payable in respect of borrowing and other long-term liabilities and the minimum revenue provision. Netted off against these expenses is interest earned on investments. The Prudential Code states that figures should be taken directly from a council's accounts and balance sheets.

21. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2006-2007 are:

	2006-07	2007-08	2008-09	2009-10	2010-11
	%	%	%	%	%
	Actual	Estimate	Estimate	Estimate	Estimate
Non-HRA	7.40	8.54	8.15	7.96	7.81
HRA	33.50	32.09	32.66	33.49	33.87

For the General Fund the net revenue stream is equal to the 'amount to be met from Government Grant and Local Tax Payers' i.e. total net expenditure. The movements in the General Fund ratio reflect the impact of the changes in the size of the capital programme in recent and over the next three years.

Impact on Council Tax and Rents

22. The Band D Council Tax that would result for 2008-2009 from the totality of the capital and revenue plans recommended in the Budget report is £1,153.06 (excluding the GLA precept). With respect to the HRA the average weekly rent that would result for 2008-2009 is £81.55.

23. Forward estimates for the Band D Council Tax for 2009-2010 and 2010-2011 are £1,187.59 and £1,223.21(excluding the GLA precept) respectively, and for the HRA the average weekly rent would be £86.12 and £90.92. These forward estimates, which are not fixed and do not commit the Council, are based on the Council's existing commitments, current plans and the totality of the capital and revenue plans recommended in the budget report. There are no known significant variations beyond this timeframe that would result from past events and decisions or the proposals in this budget.

24. The estimate of the incremental impact of the revenue costs resulting from the capital investment decisions proposed elsewhere on the Cabinet's agenda are shown below. The increase in housing rents will be used to contribute towards the cost of the housing capital programme and will enable the council to meet the government's decent homes standard.

	2008-09	2009-10	2010-11
Band D Council Tax	£5.87	£5.89	£11.81
Average weekly housing rents	£81.55	£86.12	£90.92

Borrowing

25. In respect of its external debt, it is proposed that Cabinet recommends to Council that it approve Authorised Limits for its total external debt for the next three financial years. These limits separately identify borrowing from other long-term liabilities. The Council's Chief Finance (Section 151) Officer, under existing delegated authority, will use the approved limits to effect movement between the separately agreed limits for borrowing and other long-term liabilities, in accordance with option appraisal and best value for money for the Authority, always providing that the total limit for the year is not exceeded.

26. Cabinet are asked to recommend to Council the following Authorised Limits and Operational Boundaries for external debt. The limits are consistent with the Council's planned capital expenditure and financing.

	2007-08 £m	2008-09 £m	2009-10 £m	2010-11 £m
Authorised Limit for External Debt				
Borrowing	233	271	304	341
Other long term liabilities	-	-	-	-
Total	**233**	**271**	**304**	**341**
Operational Boundary for External Debt				
Borrowing	198	236	269	306
Other long term liabilities	-	-	-	-
Total	**198**	**236**	**269**	**306**

27. The Authorised Limit determined for 2008-2009 is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Net Borrowing and Capital Financing Requirement

28. The actual Capital Financing Requirement at 31 March 2007 and estimates for the current, and future years are set out below,

As at 31 March	2007	2008	2009	2010	2011
	£000	£000	£000	£000	£000
	Actual	Estimate	Estimate	Estimate	Estimate
Non-HRA	153,856	167,710	166,095	174,544	186,656
HRA	38,030	45,348	50.649	51,216	51,977

29. In day-to-day cash management no distinction can be made between revenue cash and capital cash, meaning that external borrowing can arise as a result of the combined financial transactions of the authority and not simply those that arise from capital expenditure. In contrast, the Capital Financing Requirement measures the Council's underlying need to borrow purely for capital purposes. In accordance with best practice, the council does not associate borrowing with particular items or types of expenditure. The Cabinet approves a treasury management strategy on an annual basis and has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Services'.

30. The Prudential Code states that, in order to ensure that over the medium-term borrowing will only be for a capital purpose, a local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the previous year plus the estimates of any additional Capital Financing Requirement for the current and next two financial years. At end of December 2007 borrowings are £194m and by 31 March 2008 are estimated at £232m.

Interest Rate Exposures

31. Fixed rate borrowing and investment can contribute significantly to reducing the uncertainty surrounding future interest rate movements, however the pursuit of optimum performance may justify retaining a degree of flexibility through the use of variable rates for some element of borrowing. The Code identifies two indicators that will provide the Operational Boundaries for the exposure to interest rate risks.

   - Upper limits for variable rate exposure
   - Upper limits to fixed interest rate exposure

32. The Code requires that limits are set as a percentage of either net principal outstanding or net interest payable. At present, PWLB and Bank long-term loans are at fixed rate and the bulk of investments are deemed to be variable, being held in deposits through money market operations. Although major debt restructuring has already been actioned in 2007-2008, resulting in significant savings, the debt structure will be kept under review. The debt structure is now in a more balanced position and interest rate exposure will continue to be a factor in any borrowing decisions taken.

Maturity Structure of Borrowing

33. The code states that a local authority should set for the forthcoming financial year limits with respect to the maturity structure of its borrowing. These Prudential Indicators will be for both upper and lower limits and are calculated as the amount of projected borrowing at fixed rates that are due to mature in each period expressed as a percentage of the total projected borrowing that is at fixed rates.

34. The maturity of the debt is determined by reference to the earliest date on which the lender can require payment. After considering the current maturity profile of the Council's debt (as shown in appendix 4) the following limits, which are unaltered from the current year, are recommended

Prudential Code Limits	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months, and under 24 months	20%	0%
24 months, and within 5 years	30%	0%
5 years, and within 10 years	40%	10%
10 years and above	85%	10%

35. The debt restructuring exercise carried out in 2007-2008 increased the average duration of debt. If there is a need to take future loans to balance the debt profile and interest rates are attractive, the period of the loan, compared to the existing debt profile (Appendix 4) will be a factor in any decision.

Investing for periods longer than 364 days

36. The code states that where a local authority invests, or plans to invest, for periods longer than 364 days an upper limit will be set for each forward financial year. The purpose of this indicator is for a local authority to contain its exposure to the possibility of loss that may arise as a result of its having to seek early repayment or redemption of principal sums invested. This is one of the freedoms offered to local authorities by the new regime. In a volatile market and partly to offset the problems that can be caused by the high ratio of fixed rate debt to variable rate investments it proposed that the following limits are again set for sums invested for maturity in future years as follows:

To mature within:			% of portfolio
Year 1	365 days to 1 year 364 days	£10m	10% (approx)
Year 2	2 years to 2 years 364 days	£5m	5% (approx)
Year 3	3 years to 3 years 364 days	£5m	5% (approx)

37. The actual amounts invested for these longer periods will be determined as part of the ongoing management of the investment of the Council's general balances, and will depend on the rates on offer at the time, and any funds that may be held in future and earmarked for a particular purpose, such as PFI receipts. Since January the money market has been very volatile and Bank of England has indicated there could be further base rate cuts by end of 2008. It should be noted that the above limits apply only to the investments managed internally.

External Advice

38. As part of the partnership with Capita, Sector Treasury Services were engaged to carry out a review of the Council's balance sheet. As part of the review major debt restructuring has been actioned as referred to above. Sector will continue to advise on treasury management issues.

Financial Implications

39. This is a report of the Director of Corporate Finance and deals with financial matters throughout.

Legal Implications

40. Compliance with the DCLG Guidance and the CIPFA Code of Practice will help ensure compliance with the relevant law.

Performance Issues

41. There are no direct implications for individual performance indicators. The Treasury Management policy and implementation form an integral part of the budget process and represents financial resources approved to implement the Council's corporate priorities. Monitoring of the Council's treasury activities is ongoing, particularly given the current low level of revenue reserves, and is essential for good financial management. If this monitoring process is not maintained the implementation of budget and corporate priorities will be less transparent and less robust.

Section 3: Statutory Officer Clearance

Name: Barry Evans Date: 16 January 2008	✔	On behalf of the Chief Finance Officer
Name: Helen White Date: January 2008		On behalf of the Monitoring Officer

Section 4: Performance Officer Clearance

Name: Tom Whiting Date: 21 January 2008		Divisional Director (Strategy & Improvement)

Section 5: Contact details and background papers

Contact: Barry Evans tel: 020-8424-1203

Background Papers:

- The Prudential Code for Capital Finance in Local Authorities (CIPFA)
- Treasury Management in the Public Services : Code of Practice and Cross Sectoral Guidance Notes (CIPFA)
- Local Government Investments – Guidance (Office of the Deputy Prime Minister)

Local Government Investments

Revised guidance from the DCLG relating to Local Government Investments came into effect on 1 April 2004. The main points of the Guidance are outlined below.

- The Approved Investments Regulations ceased on 1 April 2004
- Priority when making investments should be given to security and liquidity, rather than yield. Yield should not be ignored; it is reasonable to seek the highest rate of interest, though this needs to be consistent with proper levels of security and liquidity.
- The speculative procedure of borrowing purely in order to invest and make a return remains unlawful
- There are two types of investment – specified and non-specified

Specified

These investments must be in sterling, with a maturity of no more than 1 year and with either:

1. The UK government or a UK local authority
   OR
2. Bodies or investment schemes with a 'high' credit rating

No definition is given in the Guidance as to what is considered 'high' for each type of investment. The Council's Annual Treasury Management Strategy is to determine what is 'high' and will say how frequently ratings will be monitored

Non-specified

The Annual Treasury Management Strategy must deal in more detail with non-specified investments, because of the greater potential risk. It must identify the general types of investments that may be used and set a limit to the overall amount that may be held. This can be a fixed amount or a percentage. The Strategy should also give guidelines on making decisions about such investments e.g. taking of professional advice.

- The Strategy must lay down principles for determining the amount of funds that can prudently be committed for more than a year and the minimum amount that is to be held in short-term investments.
- The Annual Treasury Management Strategy (and any variations) is to be approved by the full Council and made available to the public.
- This guidance does not apply to council Pension Funds.

With regard to credit ratings for Specified Investments appendix 2 shows the credit rating for each of the institutions on the Council's lending list, together with suggested additions that meet the FITCH rating. Non-UK banks were introduced to the list on the basis of the following minimum FITCH IBCA ratings, shown with their definitions.

<u>Long Term AA-</u>

Very high credit quality – AA ratings denote a very low expectation of credit risk, a very strong capacity for timely payment of financial commitments and are not significantly vulnerable to foreseeable events.

Short Term F1+
Highest credit quality – F1 indicates the strongest capacity for timely payment of financial commitments, the ‘+’ denotes an exceptionally strong credit feature.

Support 2
A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question.

Individual B
Category ‘A’ denotes a very strong bank; category ‘B’ is a strong bank, where there are no major concerns. Characteristics may include strong profitability and balance sheet integrity, franchise, and management, operating environment or prospects.

Ratings will be checked on a monthly basis, on receipt of the ratings guide from FITCH Ratings Ltd.

Investments with Building Societies are non-specified. With the exception of the Nationwide, none of the building societies have credit ratings that could be termed ‘high’. The bulk of the Council’s investments are held with building societies that have a wide asset base. Lending limits are set dependent upon the asset size of the building society. The limit that was applied on investments with non-specified Building Societies is 90% of the Council’s internally managed Investments (at the time of the deal). This works well and it is proposed that this should continue. To reduce risk further, a limit is also set on the amount placed with any one building society at any time and investment with smaller societies has a maximum duration of 364 days.