

BABERGH DISTRICT COUNCIL

FROM: Director of Finance

REPORT NUMBER: **K190A**

TO: COUNCIL

DATE OF MEETING: 22 February 2011

TREASURY MANAGEMENT STRATEGY 2011/12

1. PURPOSE OF REPORT

- 1.1 To present the proposed treasury management strategy, which sets out the annual investment strategy for managing surplus funds and borrowing strategy for the financial year 2011/12, in accordance with the 2009 CIPFA Code of Practice on Treasury Management in the Public Services.
- 1.2 The Code of Practice recommends the strategy is subject to scrutiny before it is recommended to Council (via Strategy Committee). The ongoing scrutiny of the Council's Treasury Management Strategy and Policies will continue to be undertaken by Overview and Scrutiny (Stewardship) Committee.

2. RECOMMENDATIONS TO COUNCIL

- 2.1 That the key factors and information on treasury management activities set out in Appendix 1 be noted.
- 2.2 That the proposed Treasury Management Strategy for 2011/12, including the Policy Statement and the Annual Investment Strategy as set out in Appendix 2, be approved.
- 2.3 That the Prudential Indicators and Limits 2011/12 to 2013/14 set out in Appendix 3 be approved.
- 2.4 That, with regards to the potential additional borrowing of £75m in relation to the proposed new Council Housing reforms, that this be subject to the Government's emerging proposals and that further details on this be reported to Members in due course.

3. FINANCIAL IMPLICATIONS

- 3.1 Expected income in 2010/11 is likely to be about £47k compared to £70k in 2009/10. Income generated from the investment of surplus funds will continue at these relatively low levels in 2011/12 until such time as interest rates increase.

- 3.2 The revenue cost of borrowing requirements in relation to the capital programme in 2011/12 will be minimised by borrowing on the most beneficial basis at the most appropriate time of the year, based on advice from our Treasury Advisors (Arlingclose). The proposed draft General Fund budget for the year of £326k, which covers the minimum revenue provision for principal repayments and interest, should be sufficient to meet these costs although there are risks on anticipated capital receipts not being received and borrowing rates increasing.

4. **RISK MANAGEMENT**

- 4.1 This report is most closely linked with Significant Business Risk No. 6 – Performance and Cost Management Management. The following risks are associated with this strategy:

Risk Description	Likelihood	Seriousness or Impact	Mitigation Measures
Loss of investment	Low	Critical	Strict lending criteria for highly credit rated institutions.
Poor return on investments/ Liquidity	High	Marginal	Focus is on security and liquidity, therefore, careful cashflow management and budget monitoring in accordance with the Strategy, is undertaken.
Higher than expected borrowing costs – interest rate increases/lower capital receipts than forecast	Low	Marginal	Benchmark is to borrow from the Public Works Loan Board whose rates are very low and can be on a fixed or variable basis. Alternatively, continue to use of internal surplus funds temporarily. Capital receipts monitored as part of quarterly performance reporting to Members.

5. **KEY INFORMATION**

Background

- 5.1 The 2009 CIPFA Code of Practice for Treasury Management in Public Services (the CIPFA TM Code) and the Prudential Code require local authorities to determine their Treasury Management Strategy Statement (TMSS) and Prudential indicators on an annual basis. The TMSS also incorporates the Investment Strategy for the year.

- 5.2 The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 20 April 2010. The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.
- 5.3 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are an integral element to treasury management activities and include Credit and Counterparty Risk, Liquidity Risk, Market or Interest Rate Risk, Refinancing Risk and Legal and Regulatory Risk.
- 5.4 The Strategy takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position. The current and projected Treasury position as at December 2010 is shown at section 5 in Appendix 1.
- 5.5 The key purpose of the TMSS is to approve:
- Treasury Management Strategy for 2011/12 (Appendix 2)
 - Prudential Indicators (Appendix 3)
- 5.6 In relation to borrowing, the MRP Statement (Minimum Revenue Provision) is presented to Council within the Budget Report. This governs the approach to making financial provision for repaying borrowings.
- 5.7 All treasury activities will comply with relevant statutes, guidance and accounting standards.

2011/12 Strategy

- 5.8 Treasury Management is an important part of the overall financial management of the Council's affairs. The Prudential Indicators in Appendix 3 consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework. Effective management and decisions on funding ensure the Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.
- 5.9 Key documents relating to the Council's treasury management operations in terms of the annual investment and borrowing strategy proposed for 2011/12 are set out in the supporting appendices. Factors affecting the strategy are detailed in Appendix 1 and the proposed strategy for the year is set out in Appendix 2.
- 5.10 The proposed investment strategy for 2011/12 continues to primarily focus on the effective management and control of risk, giving priority to security and liquidity when investing funds. Investment returns remain an important but secondary consideration.
- 5.11 Changes have been made to the minimum investment criteria for UK counterparties in the 2011/12 Strategy. The maximum investment limit per institution remains at £2m for all specified investments. There is no limit on the amount invested with the Government's Debt Management Agency deposit Facility (DMADF).

- 5.12 No investments will be made with Santander UK plc, even though they currently meet the Council’s high credit rating criteria, on the basis that Members and the Director of Finance believe that it is not appropriate at the current time to lend to any banks with connections to countries that are experiencing severe economic difficulties. This will be kept under review and the position will only be reconsidered, with Member approval, should that position change
- 5.13 Key aspects and changes proposed to the investment strategy are summarised in the table below:

Aspect	2011/12 Strategy
Specified Investments – High credit rated institutions	<ul style="list-style-type: none"> • The minimum criterion for UK investments has been increased from A to A+, or equivalent across all assigned ratings, on the advice of our Treasury advisor, Arlingclose. • The minimum criterion for foreign banks is unchanged and remains higher with an individual long-term rating of AA- (or equivalent) and a Fitch long-term sovereign/country rating of AAA, which equals the sovereign/country rating of the UK. • One additional UK counterparty is included in the ‘lending list’ (see Appendix 5) - the Clydesdale Bank, this is a UK bank and is part of the National Australia Bank Group. • One additional foreign bank is included, Nordea Bank Finland, and a number of foreign banks have been removed. • The list of “high credit quality” investments has been expanded to include: <ul style="list-style-type: none"> ❖ AAA-rated Variable Net Asset Value (VNAV) Money Market Funds ❖ T-Bills (short-term government debt instruments issued by the Debt Management Office) ❖ Local Authority Bills (similar to T-Bills but issued by individual local authorities).
Non-specified investments	<ul style="list-style-type: none"> • The only non-specified investment (for less than a year) will continue to be in an instant access call account with its own Bankers, Co-operative Bank. This is non-specified as the Bank does not meet the Council's high credit rating criteria, which is due in part to the merger of the Co-operative Bank with the Britannia Building Society • Any investment over 1 year must be classified as a non-specified investment. This would only be undertaken with institutions satisfying the high credit ratings that have been set for specified investments and will only be used with the prior approval of the Director of Finance.

Aspect	2011/12 Strategy
Borrowing	<ul style="list-style-type: none"> New borrowing/restructuring – consideration will be given to all forms of borrowing/financing: PWLB, Markets, EIB, Bond Issues, Other Local Authorities and LA Bills, structured finance, leasing, etc.

- 5.14 A list of the Banks and Building Societies that the Council is currently able to lend to (as at end of December 2010) is provided in Appendix 4. This will be continuously monitored as the position will change throughout the year as Fitch and the other rating agencies continuously review credit ratings and additional information. Spain, Greece, Ireland, Italy and Portugal are not included on the Counterparty list as they do not meet the required high credit rating. There remains very limited scope for placing investments in the Building Society sector.
- 5.15 The period for which an investment will be made is a key aspect of the investment strategy. This criterion is set out in Table 1 in Appendix 2. In essence, a short-term investment strategy (up to 364 days) will remain the Council's core approach and longer-term deposits, in excess of 364 days, will only be undertaken with prior approval of the Director of Finance.
- 5.16 In terms of prudential borrowing, anticipated requirements are around £1.9m in 2011/12 in relation to the General Fund capital programme although that would be affected by any capital expenditure carried forward from 2010/11 and changes in the amounts or timing of capital receipts.
- 5.17 There is no supported borrowing for the HRA beyond 2010/11. However, in relation to additional borrowing and the proposed introduction of the new Council House reforms system for the Housing Revenue Account, Appendix 3 indicates that £75m could be required in 2011/12 (before the new system, if it is introduced, comes into being in April 2012). Members will be advised further during the year on developments.
- 5.18 Officers will take advice on the optimum time to undertake additional borrowing in terms of the type e.g. maturity or Equal Instalments of Principal (known as EIP), period of loan, fixed or variable interest rate (although the likely preference is fixed) and over what period or whether it is viable to continue to use internal surplus funds. Further details on this are provided in Appendix 2 and 3.
- 5.19 The contract for external treasury management advisors was tendered jointly with Mid Suffolk DC. The contract was awarded to Arlingclose Ltd from 1 June 2010 for a 2 year period (with an option to extend).

6. **EQUALITY IMPACT ASSESSMENT**

- 6.1 Not relevant to the strategy as it covers issues that will not have any equality of diversity impacts.

7. **APPENDICES**

- 1 Key Factors and Information on Treasury Management Activities
- 2 Treasury Management Strategy 2011/12
- 3 Treasury Management Indicators and Prudential Indicators 2011/12 to 2013/14
- 4 Institutions meeting high credit ratings criteria (as at end of December 2010)

8. **BACKGROUND PAPERS REFERRED TO:**

CIPFA Treasury Management in the Public Services: Code of Practice

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Key Factors and Information on Treasury Management Activities

1 Interest Rates

- 1.1 The economic interest rate outlook provided by the Council's Treasury Advisor, Arlingclose Ltd, is shown in the table below. The Council will reappraise its strategy from time to time and, if needed, this will be realigned having regard for evolving market conditions and expectations for future interest rates.
- 1.2 The UK Bank Rate has been maintained at 0.5% since March 2009, and it is anticipated to remain at low levels throughout 2011/12. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.
- 1.3 The initial reaction to the CSR is positive, but implementation risks remain.
- 1.4 The restructuring of UK bank balance sheets is ongoing and expected to take a long time to complete, and is a pre-condition for eventual normalisation of credit conditions and bank lending. Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Official Bank Rate													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75	2.75	3.00	3.00	3.00
Downside risk	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
1-yr LIBID													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	1.65	1.90	2.15	2.40	2.50	2.50	2.75	3.00	3.25	3.50	3.50	3.50	3.50
Downside risk	- 0.25	- 0.25	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
5-yr gilt													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	2.75	3.00	3.25	3.50	3.75	4.00	4.00	4.00	4.00	4.00	4.25	4.25	4.00
Downside risk	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25

2 Investments

- 2.1 The Government's guidance on Local Government Investments under the Local Government Act 2003 emphasises that priority be given to security and liquidity, rather than yield. However that does not mean that authorities should ignore yield. It will be reasonable to seek the highest rate of interest consistent with the proper levels of security and liquidity. This has always been this Council's approach, in line with the CIPFA Code of Practice on Treasury Management.

- 2.2 Detailed cash flow projections are maintained by officers, taking into account all factors affecting surplus funds that are, potentially, available for investment. This means that working capital requirements can be ascertained with a reasonable degree of certainty.
- 2.3 The Council's proposed counterparty list as at 31 December 2010 is set out in Appendix 4. This lists institutions currently meeting "high credit ratings" criteria for approval. The counterparty list will be updated throughout the year as credit ratings agencies and a range of non-credit rating information including generally available market information is reviewed.

3 Borrowing

- 3.1 The Prudential Code states that a prudent financial strategy (i.e. not borrowing to fund revenue expenditure or to invest) is one where in the medium term net borrowing is only to be used for capital purposes. This is applied to the Council's strategy.
- 3.2 Officers have undertaken a fundamental review of the Council's borrowing during the year and increased fixed rate borrowing to take advantage of relatively low interest rates. Arlingclose continue to recommend following a low risk strategy and arranging additional debt on a variable rate basis, on an equal instalment of principal basis, or long-term at fixed rates where affordable.

4 Risk Benchmarking

- 4.1 The revised code requires the Council to consider the use of benchmarking to support the Treasury Management activity and this is addressed in the Treasury Management Practices (TMPs).
- 4.2 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 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.
- 4.3 Arlingclose provides a quarterly benchmarking report which assesses credit risk and liquidity as well as return.

5 Existing Investments and Borrowing

Existing Portfolio and Future Projection	Current Portfolio as at December 2010 £m	%	Existing Borrowing/ Investments as at 31 Mar 11 £m	Existing Borrowing/ Investments as at 31 Mar 12 £m	Existing Borrowing/ Investments as at 31 Mar 13 £m	Existing Borrowing/ Investments as at 31 Mar 14 £m
External Borrowing:						
Fixed Rate – PWLB	(1.1)	33	(1.1)	(1.1)	(1.1)	(1.1)
Fixed Rate - EIP	(2.0)	61	(1.9)	(1.7)	(1.5)	(1.3)
Total External Borrowing	(3.1)		(3.0)	(2.8)	(2.6)	(2.4)
Existing long-term liabilities	(0.2)	6	(0.2)	(0.1)	0.0	0.0
IFRS Long Term Liabilities:						
- Operating Leases	0.0		0.0	0.0	0.0	0.0
Total Gross External Debt	(3.3)	100	(3.2)	(2.9)	(2.6)	(2.4)
Investments:						
- Short-term monies	10.0	74	1.1	0.0	0.0	0.0
- Deposits/ monies on call	3.6	26	0.3	0.0	0.0	0.0
- MMFs	0.0		0.0	1.0	0.0	0.0
Total Investments	13.6	100	1.4	1.0	0.0	0.0
(Net Borrowing Position)/ Net Investment position	10.3		(1.8)	(1.9)	(2.6)	(2.4)

Treasury Management Strategy for 2011/12

Treasury Management Policy Statement

1. Babergh District Council defines its treasury management activities as: “the management of the organisation’s investments and cash flows, it’s banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance associated with those risks.”
2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of the treasury management activities as defined above will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on the risk implications for the Council, arising from those activities.
3. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques within the context of effective risk management.

Background

4. Treasury Management is strictly regulated by statutory requirements. The professional code of practice has been revised and the Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice, November 2009, in April 2010.
5. The Local Government Act 2003 and supporting regulations requires the Council to have regard to the Prudential Code and set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.
6. The Act also requires the Council to set out its treasury strategy for borrowing and investment.

Investment of Surplus Funds

7. The Government’s guidance on Local Government Investments under the Local Government Act 2003 emphasises that priority be given to security and liquidity, rather than yield. The Council’s investments priorities are:
 - Security of the invested capital
 - Liquidity of the invested capital
 - An optimum yield which is commensurate with security and liquidity.
8. The overall investment strategy is to ensure prudent investment of surplus funds.

9. This Investment Strategy states which instruments the Council may use for investment purposes (current Counterparty list shown in Appendix 4), making a distinction between Specified and Non-Specified Investments, based on the criteria in the CLG Guidance. The Director of Finance, under delegated authority, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Overview and Scrutiny (Stewardship) Committee within the Quarterly Finance and Performance Report.
10. The Council's current level of investments is presented at section 5 in Appendix 1.
11. The Council's in-house investments are made with reference to the outlook for the UK bank Rate and money market rates.
12. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.
13. The Council selects countries and the institutions within them, from the counterparty list after analysis and careful monitoring of:
 - Credit Ratings
 - Credit Default Swaps (where quoted)
 - GDP; net Debt as a Percentage of GDP
 - Sovereign Support Mechanisms/potential support from a well-resourced parent institution
 - Share Prices (where quoted)
 - Macro-economic indicators
 - Corporate developments, news and articles, market sentiment.
14. The Council and Arlingclose will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.
15. Investment options for 2011/12 will be monitored and carefully considered in conjunction with Arlingclose - maximum levels of surplus funds are likely to be in the range of £5-13m but will obviously be lower than this at certain times during the year and depending on whether any of these internal funds are used for financing capital expenditure borrowing requirements.
16. The Council has placed an upper limit of £3m for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise as a result on the Council having to seek early repayment of the sums invested.

17. To protect against a prolonged period of low interest rates and to provide certainty of income, 2-year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified investments. Prior approval of the Director of Finance is required. The longer-term investments will be likely to include:
- Term deposits with counterparties with the required credit rating.
 - Supranational Bonds (bonds issued by multilateral development banks). Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.
18. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Specified Investments

19. Specified investments are those expected to offer high security and liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines specified investments as follows:
- is sterling denominated
 - has a maximum maturity of 1 year
 - meets the “high credit quality” as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
 - the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).
20. The Council defines the following as being of “high credit quality” for making specified investments, subject to the monetary and time limits shown in table 1 below.
- a. Deposits in the DMO’s Debt Management Account Deposit Facility
 - b. Deposits with UK local authorities
 - c. Deposits with banks and building societies
 - d. *Certificates of deposit with banks and building societies
 - e. *Gilts: (bonds issued by the UK government)
 - f. *Bonds issued by multilateral development banks
 - g. Treasury-Bills (T-Bills)
 - h. Local Authority Bills (LA Bills)
 - i. AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV) – £1 asset value maintained and interest accrued on a daily basis.
 - j. *AAA-rated Money Market Funds with a Variable Net Asset Value (VNAV) – £1 asset value can go up or down, therefore, prior approval of the Director of Finance is required.
 - k. Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

* Investments in these instruments will be on advice from the Council's Treasury Advisor, Arlingclose.

21. For the purposes of 20 a to j above, the Council considers a high credit rating for these to be as follows. Decisions are made based on the lowest common denominator approach, i.e. the lowest rating:

Table 1 Specified Investments

Form of investment	Minimum Credit Rating Criteria		
	Fitch	Standard & Poor's	Moody's
Deposits - UK Banks & Building Societies (Max. sum per lender £2m)	Short term F1 Long term A+	Short term A-1 Long term A+	Short term P-1 Long term A1
Deposits - Foreign Banks (sovereign rating AAA/AAA/Aaa) (Max. sum per lender £2m)	Short term F1+ Long term AA-	Short term A1+ Long term AA-	Short term P1 Long term Aa3
Deposits - Money Market Funds	AAAmf	AAAm	Aaa/MR1+

Note 1: Banks within the same group ownership are treated as one bank for limit purposes. Sovereign country ratings will also be taken into account in undertaking any deposits.

Note 2: No investments will be made with Santander UK plc, even though they currently meet the Council's high credit rating criteria, on the basis that Members and the Director of Finance believe that it is not appropriate at the current time to lend to any banks with connections to countries that are experiencing severe economic difficulties. This will be kept under review and the position will only be reconsidered, with member approval, should that position change.

22. Arlingclose monitor Individual and Support ratings and Bank Financial Strength Rating (BFSR) and will notify any changes to these ratings for counterparties on the Council's lending list. Officers will consider this and all other market information, corporate developments and market sentiment towards investment counterparties.

23. In addition to applying investment limits to individual institutions, clear country and sector limits should also be set. The following table summarises the various limits that should apply:

Sector Limits	Maximum limit of total investments 2011/12
UK Banks (Deposits & Call Accounts)	100%
UK Building Societies	15%
Deposits - Foreign Banks	40%
Money Market Funds	50%
Local Authorities	100%
DMADF	100%

Note 3: Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

Credit Ratings

24. Security of investments is currently evidenced by the application of a minimum credit quality criterion to investment counterparties. Credit ratings are obtained and monitored by Arlingclose who will notify changes in ratings as they occur. Where a country or institution has its credit rating downgraded so that it fails to meet the minimum criteria then:

- No new investments will be made,
- Any existing investments that can be recalled at no cost will be recalled
- Full consideration will be given to the recall of any other existing investments

Where a credit rating agency announces that it is actively reviewing an organisation’s credit ratings with a view to downgrading it so that it is likely to fall below the minimum criteria, then no further investments will be made until the outcome of the review is announced. This specifically refers to “negative watch” and “review for possible downgrade”, but not to “negative outlook”.

25. The maximum period for individual investments meeting the highest primary criteria is up to 1 year, maximum 364 days, and regard will be had to any time-limited Government guarantees. Investments over 6 months (over 185 days) are subject to the prior approval of the Director of Finance or Corporate Finance Manager.

Non-Specified Investments

26. Any investment that does not meet the criteria for Specified Investments is deemed to be a Non-Specified Investment.

- 27. Non-specified Investments, therefore, imply higher risk and relate to:
 - i. Any investment with an institution that does not meet the high credit rating criteria set by the Council, which includes non-credit rated institutions, including a number of Building Societies.
 - ii. Investments made for periods greater than 1 year, which are considered less liquid as the cash is not quickly realisable.

- 28. The Government has always recognised that, provided precise procedures are in place to determine and assess suitable institutions for non-specified investments, they should not be considered less secure than specified investments

- 29. It is clear, therefore, from the above that the intention is not to discourage the use of Non-Specified Investments, but to make sure that they are properly considered and that there are appropriate procedures in place for risk management.

- 30. Following very careful consideration, it has been concluded that the Council should not undertake any non-specified investments other than:
 - i. In an instant access call account with its own Bankers, i.e. Co-operative Bank, even though they do not quite meet the Council's high credit rating criteria.
 - ii. Investments of over 1 year in accordance with the high credit rating criteria set out for specified investments in section 21.

- 31. The Council is required to set limits for each type of non-specified investment, expressed as either a sum of money or as a percentage of total investments. This can range from 0 to 100% and is set out below. Advice on any investments over 1 year will be sought from Arlingclose.

Instrument	Limit
Co- operative Bank call account	£2m
Term Deposits (maturity date > 1 year)	25%
Callable Deposits (maturity date > 1 year)	£1m
Forward Deals (maturity > 1 year)	£1m

Liquidity of Investments (both specified and non-specified)

- 32. The Secretary of State recommends that the Investment Strategy sets out the procedures for determining the maximum periods for which funds may be prudently committed.

- 33. The level of funds to be committed will be determined based on the criteria set out in section 21, cash flow forecasts and the identification of core-cash. At a more detailed level, the appropriate period of investing will be based on on-going advice from Arlingclose.

34. Arlingclose advise a cautious approach to investments by using named counterparties with a long-term rating of A+ or equivalent across all assigned ratings (in accordance with CIPFA's lowest common denominator approach). For foreign banks the sovereign rating is a minimum of AAA (or equivalent) with an individual minimum counterparty long-term rating of AA- (or equivalent).
35. A rolling programme of short term deposits is in operation where cash flows permit.

Borrowing and Rescheduling Strategy

36. This is to provide a framework for capital expenditure decision making, highlighting through the prudential indicators the level of capital expenditure, the impact on borrowing and investment levels and the overall controls in place to ensure the plans are affordable, prudent and sustainable. As the Council's net external borrowing does not exceed the total Capital Financing Requirement, we are in a position to borrow if deemed necessary
37. The Council has an asset base of £210m and can borrow to maintain that and provide new or improved facilities, subject to affordability.
38. Under the Prudential Code, there is a requirement to set a Prudential Indicator for an authorised limit for external debt. This is included in Appendix 3.
39. The authorised limits for borrowing are consistent with current commitments, existing plans and the proposals in the budget report for capital expenditure and financing. The Prudential Indicators for each year reflect the current outlook for borrowing and are set as maximum limits rather than actual borrowing levels.

Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

40. Treasury activity is monitored quarterly through the Quarterly Finance and Performance Report to Overview and Scrutiny (Stewardship) Committee and an operational report is provided monthly to the Director of Finance. The Prudential Indicators are monitored through the year and are reported in the annual and half-yearly reports to Council.
41. An annual outturn report on Treasury activity is provided to full Council no later than 30 September after the financial year end.
42. The Overview and Scrutiny (Stewardship) Committee is responsible for the scrutiny of treasury management activity and practices.

Member and Officer Training

43. The Council recognises the importance of ensuring that all staff and members responsible for the delivery and scrutiny of the treasury management function are appropriately skilled and trained to undertake their duties. All training requirements are addressed through a range of internally or externally provided sessions appropriate to the skill/ knowledge gaps and responsibility levels.

Treasury Management Advisors

44. The Council's treasury management advisors are Arlingclose Ltd whose contract commenced on 1 June 2010. The treasury advisor service is subject to regular review to ensure compliance with the requirements of the Treasury Management Strategy and TMPs' Use of External Service Providers.
45. Whilst the advisors provide support to the treasury function, under current market rules and the CIPFA code of Practice, the final decision on treasury matters remains with the Council.
46. The treasury advisor service includes a range of services:
- Technical support on treasury matters, capital finance issues, drafting the Treasury Management Strategy and advice on preparing the annual and half-yearly reports.
 - Economic and interest rate analysis
 - Debt services including advice on borrowing
 - Credit ratings/generic market information comprising the three main credit rating agencies, generally available market information and information on government support for banks and the credit ratings of that government support.

Balance Sheet and Treasury Position

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

Table 1 – Capital Financing Requirement, Balances and Reserves

	Estimate 2009/10 £m	Actual 2009/10 £m	Revised 2010/11 £m	2011/12 £m	Estimates 2012/13 £m	2013/14 £m
GF	2.423	1.511	1.363	2.978	4.171	4.651
HRA	5.101	5.651	6.201	6.201	6.201	6.201
TOTAL CFR	7.524	7.162	7.564	9.179	10.372	10.852
Less:						
Existing Profile of Borrowing and Other Long Term Liabilities	(1,100)	(1.100)	(3.000)	(2.800)	(2.600)	(2.400)
	(0.391)	(0.391)	(0.219)	(0.109)		
Cumulative Maximum External Borrowing Requirement	6.033	5.671	4.345	6.270	7.772	8.452
Balances & Reserves	(3.921)	(4.639)	(3.399)	(3.442)	(3.394)	(3.461)
Cumulative Net Borrowing Requirement/(Investments)	2.112	1.032	0.946	2.828	4.378	4.991

2. The Council's level of physical debt and investments is linked to these components of the Balance Sheet. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position. The Council will ensure that net external borrowing (net of investments) will not exceed the CFR other than for short term cash flow requirements.

Estimates of Capital Expenditure

3. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and to consider the impact on Council Tax, and in the case of the HRA, housing rent levels.

Table 2 – Estimates and Actual Capital Expenditure

	Estimate 2009/10 £m	Actual 2009/10 £m	Revised 2010/11 £m	2011/12 £m	Estimates 2012/13 £m	2013/14 £m
TOTAL GF	3.824	3.138	2.639	4.085	2.421	1.624
Housing (HRA)	3.570	3.582	3.617	3.006	2.955	2.955
TOTAL CAPITAL PROGRAMME	7.394	6.720	6.256	7.091	5.376	4.579

Table 3 – Financing of Capital Expenditure

Capital Financing	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2012/13 Estimate £m
Capital receipts	1.125	0.295	1.881	0.587	0.530
Government Grants	1.083	1.192	0.408	0.390	0.304
Major Repairs Allowance	2.413	2.342	2.301	2.250	2.250
Revenue contributions	0.616	1.820	0.680	0.680	0.680
Total Financing	5.237	5.649	5.270	3.907	3.764
Supported borrowing	0.550	0.550	0	0	0
Unsupported borrowing	0.768	0.057	1.821	1.469	0.815
Total Funding	1.318	0.607	1.821	1.469	0.815
Total Financing and Funding	6.555	6.256	7.091	5.376	4.579

Incremental Impact of Capital Investment Decisions

4. As an indicator of affordability the table below shows the impact of capital investment decision on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Table 4 – Incremental Impact on Council Tax and Housing Rents

	2011/12 £	Estimates 2012/13 £	2013/14 £
Council Tax at band D	0.67	4.16	2.37
Est. effect on Average weekly housing rent	(0.17)	(0.32)	(0.02)

Reform of the Council Housing Subsidy System

5. CLG consulted on proposals to reform the council housing subsidy system in July 2010. The consultation proposed a removal of the subsidy system by offering a one-off reallocation of debt. The potential to do this has been introduced in the Localism Bill presented to Parliament in December 2011 and further details are awaited. The new system is due to start in 2012.
6. This will require the Council to fund the amount owed in the medium term through internal resources and external borrowing. The Council has the option of borrowing from the PWLB or the market. The type of loans taken will be decided on in discussions with Housing Management and Arlingclose.

Ratio of Net Financing Costs to Net Revenue Stream

7. The estimate for interest payments in 2011/12 is £119k and for interest receipts is £50k. The net revenue stream is the amount of the budget to be met from Formula Grant and Council Tax income. The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on costs net of investment income.
8. The General Fund indicator becomes positive in 2010/11 due to financing costs exceeding the amount of investment income received. There is a large positive figure for the HRA as the Council has historically borrowed internal funds to finance Council Housing expenditure and these costs are reimbursed through housing subsidy.

Table 5 – Ratio of Financing Costs to Net Revenue Stream

	Estimate 2009/10 %	Actual 2009/10 %	Revised 2010/11 %	2011/12 %	Estimates 2012/13 %	2013/14 %
GF	(6.07)%	(0.62)%	1.05%	0.94%	2.91%	3.90%
HRA	20.88%	21.76%	20.21%	19.06%	18.87%	17.02%

Borrowing and Rescheduling Strategy

9. The Council's balance of actual gross borrowing plus other long-term liabilities is shown at section 5 in Appendix 1. This is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.
10. The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).
11. The Authorised Limits and Operational Boundary for External Debt shown in Tables 6 and 7 include an estimate for debt that may be allocated as a result of Housing Reform.

Table 6 – Authorised Limits for External Debt

	Estimate 2009/10 £m	Actual 2009/10 £m	Revised 2010/11 £m	2011/12 £m	Estimates 2012/13 £m	2013/14 £m
Capital Financing Requirement	7.524	7.162	7.564	9.214	10.407	10.887
Other Liabilities (Leases)	0.368	0.368	0.219	0.109	0.000	0.000
Cash Flow Deficit / Margin	1.308		1.817	1.777	1.193	1.713
Housing Reform				79.000	77.000	75.000
TOTAL	9.200	7.530	9.600	90.100	88.600	87.600

12. The Operational Boundary links directly to the Council's current commitments, estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but with the additional headroom included within the Authorised Limit.

Table 7 – Operational Boundary for External Debt

	Estimate 2009/10 £m	Actual 2009/10 £m	Revised 2010/11 £m	2011/12 £m	Estimates 2012/13 £m	2013/14 £m
Borrowing	3.117	1.100	4.000	85.700	84.300	82.300
Other Liabilities / Cash Flow Deficit	1.183	0.368	1.500	2.300	2.100	3.400
TOTAL	4.300	1.468	5.500	88.000	86.400	85.700

13. The Director of Finance has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to Council through the Quarterly Finance and Performance Monitoring Report.
14. In conjunction with advice from Arlingclose the Council will keep under review the following borrowing options:
- PWLB loans
 - Borrowing from other local Authorities
 - Borrowing from institutions such as the European Investment Bank and directly from commercial banks
 - Borrowing from the Money Markets
 - Local authority stock issues
 - Local authority bills
 - Structured finance
15. The issue of Circular 147 on 20th October 2010 following the CSR announcement increased the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing. The PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:
- Variable rate borrowing
 - Medium-term Equal Instalments of Principal (EIP) or Annuity Loans
 - Long-term Maturity loans, where affordable

16. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term and to maintain stability. The differential between debt costs and investment earnings, despite long term borrowing rates being at low levels, remains acute and this is expected to remain a feature during 2011/12. The costs associated with medium and long-term borrowing, compared to temporary investment returns, means that new fixed rate borrowing could incur additional short-term costs. The use of internal resources in lieu of borrowing may again, in 2011/12, be the most cost effective means of financing capital expenditure.
17. PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long-term rates and variable rates narrows by 0.50%, this will trigger a formal review point and options will be considered in conjunction with Arlingclose and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.
18. The rationale for rescheduling would be one or more of the following:
 - Savings in interest costs with minimal risk
 - Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
 - Amending the profile of maturing debt to reduce any inherent refinancing risks.
19. As opportunities arise, they will be identified by Arlingclose and discussed with Officers.
20. Borrowing and rescheduling activity will be included with the Quarterly Finance and Performance Monitoring Reported to Overview and Scrutiny (Stewardship) Committee.
21. The following Prudential Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

Table 8 – Interest Rate Exposure

Interest Rate Exposures	2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2010/11 Estimate %	2010/11 Estimate %
Fixed					
Upper Limit for Fixed Interest Rate Exposure on Debt	100	100	100	100	100
Upper Limit for Fixed Interest Rate Exposure on Investments	(100)	(100)	(100)	(100)	(100)
Net Fixed Exposure	0	0	0	0	0
Variable					
Upper Limit for Variable Interest Rate Exposure on Debt	30	30	30	30	30
Upper Limit for Variable Interest Rate Exposure on Investments	(30)	(50)	(50)	(50)	(50)
Net Variable Exposure	0	(20)	(20)	(20)	(20)

Fixed rate investments and borrowings are those where the rate of interest is fixed for the life of the deposit or loan. Variable rate investments and borrowing are where the rate on the deposit or loan will change on a frequent basis, e.g. daily, monthly, quarterly.

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

Table 9 – Maturity Structure of Borrowing

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within five years	50%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

This indicator applies to the financial years 2011/12, 2012/13 and 2013/14. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

APPENDIX 4

Institutions meeting high credit ratings criteria (as at end of December 2010)

The individual counterparty limit is £2m except for Banks within the same group ownership. These are treated as one bank for limit purposes. The country limit is £2m.

Instrument	Country Rating Fitch	Counterparty	Maximum Group Limit (if applicable) £m
UK BANKS	AAA		
Term Deposits		Bank of Scotland (Lloyds Banking Group)	} £2m
Term Deposits		Lloyds TSB (Lloyds Banking Group)	
Term Deposits		Barclays Bank Plc	
Term Deposits		HSBC Bank Plc	
Term Deposits		NatWest (RBS Group)	} £2m
Term Deposits		Royal Bank of Scotland (RBS Group)	
Term Deposits		Standard Chartered Bank	
Call Accounts		Clydesdale Bank	£2m
BUILDING SOCIETIES			
Term Deposits		Nationwide	
FOREIGN BANKS			
CANADA	AAA		
Term Deposits		Bank of Nova Scotia	
Term Deposits		Royal Bank of Canada	
Term Deposits		Toronto-Dominion Bank	
FINLAND	AAA		
Term Deposits		Nordea Bank Finland	
FRANCE	AAA		
Term Deposits		BNP Paribas	
Term Deposits		Credit Agricole CIB (Credit Agricole Group)	} £2m
Term Deposits		Credit Agricole SA (Credit Agricole Group)	
NETHERLANDS	AAA		
Term Deposits		Rabobank	
UNITED STATES	AAA		
Term Deposits		JP MORGAN	
NON-SPECIFIED			
Call Accounts	AAA	Co-operative Bank (UK)	£2m