CITY OF YORK COUNCIL

Executive **16 February 2010**

Report of the Director of Resources

Treasury Management Strategy Statement and Prudential Indicators for 2010/11 to 2014/15

Purpose

1. The purpose of this report is to ask the Executive to recommend that Council approve the:

   - integrated Treasury Management Strategy Statement including the annual investment strategy and the minimum revenue provision policy statement;
   - proposed Prudential Indicators for 2010/11 to 2014/15
   - adopt the revised CIPFA Treasury Management Code of Practice 2009 ("the Code")
   - revised Treasury Management Policy Statement
   - reporting arrangements as described by "the Code" and that Audit & Governance Committee scrutinise the Treasury Management Strategy and Monitoring reports
   - Treasury Management Scheme of Delegation and role of the section 151 officer

Summary

2. The report provides a background to why it is necessary to produce a Treasury Management strategy, a minimum revenue provision policy statement and set prudential indicators for the following three years.

3. The Council is currently undertaking a series of significant capital schemes that will realise revenue savings over the following 30 years. This high level of upfront capital investment will contribute to the rise in the Council's underlying need to borrow from the current level of approximately £113.1m in 2009/10 to over £160.1m in 2014/15. The borrowing strategy aims to minimise the risks to the Council of borrowing large amounts in a single year by giving the Council the flexibility to borrow in advance of need or reduce the amount of borrowing taken, in order to take advantage of favourable borrowing and investment interest rates as they arise.

4. The annual investment strategy reviews the projected interest rates over the next 3 years until the 2011/12 financial year, and seeks to maximise the returns to the Council whilst minimising the risks involved in placing deposits on the money market.

5. The CIPFA[1] Treasury Management in the Public Services Code of Practice (the Code) and the Cross-Sectoral Guidance Notes have been revised during 2009 in light of the Icelandic situation in 2008.

Background

6. The Local Government Act 2003 requires the Council to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) that sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

7. As part of the strategy, the Local Government Act 2003 also requires the Council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for a minimum of the next three years to ensure the Council's capital investment plans are affordable, prudent and sustainable. The strategy therefore is affected by the Council's capital spending plans, as set out in the Capital Programme Budget report and the revenue implications of these that are reflected in the Revenue Budget report, both presented to Full Council on 25 February 2010.

8. In addition, the local Government Act 2003 also requires the Council formally to adopt the CIPFA Treasury Management Code of Practice. The revised code has emphasised a number of key areas that need to be taken into account in future and these are detailed in the body of the report.

9. The suggested strategy for 2010/11 in respect of the following aspects of the treasury management function is based upon the Director of Resources views on interest rates, supplemented with market forecasts provided by Sector Treasury Services, the Council's treasury management adviser. The strategy covers:

    - The requirements of the revised CIPFA Treasury Management Code of Practice 2009 (paragraph 8-18)
    - Balanced Budget Requirement (paragraph 19)
    - Treasury limits in force which will limit the treasury risk and activities of the Council (paragraph 20 -22);
    - Prudential Indicators (paragraph 23 –25);
    - Current treasury position (paragraph 26-29);
    - Prospects for interest rates (paragraph 30 -32);
    - Economic Background (paragraph 33)
    - Borrowing strategy (paragraph 34-41);
    - Policy on Borrowing in advance of need (paragraph 42-44)
    - Policy on gross and net debt (paragraph 45-51)
    - Debt rescheduling (paragraph 52-56);
    - Investment strategy (paragraph 57-64);

[1] Chartered Institute of Public Finance and Accountancy (CIPFA)

- Creditworthiness Policy (paragraph 65-71)
- Minimum Revenue Provision strategy (paragraph 72 -77)
- Policy on external advisers (paragraph 78-80)
- Scheme of Delegation / Role of the Section 151 Officer (paragraph 81)

Consultation and Options

10. The treasury management function of any business is a highly technical area, where decisions are often taken at very short notice in reaction to the financial markets. Therefore, to enable effective treasury management, all operational decisions are delegated by the Council to the Assistant Director of Resources (Finance), who operates within the framework set out in this strategy and through the Treasury Management Policies and Practices. In order to inform sound treasury management operations the Council works with its Treasury Management advisers, Sector Treasury Services. Sector Treasury Services offer the Council a comprehensive information and advisory service to enable the Council to maximise its investment returns and minimise the costs of its debts.

11. Treasury Management strategy and activity is influenced by the capital investment and revenue spending decisions made by the Council. Both the revenue and capital budgets have been through a corporate process of consultation and consideration by the elected politicians. The revenue budget and capital budget proposals are included within this agenda.

12. At a strategic level, there are a number of treasury management options available which depend on the Council's stance on interest rate movements. This report sets out the Council's stance and recommends the setting of key trigger points for borrowing and investing over the forthcoming financial year.

Analysis

Revised CIPFA Treasury Management Code of Practice 2009

13. The CIPFA Treasury Management in the Public Services Code of Practice "the Code" has been revised during 2009, in light of the Icelandic situation in 2008. It is a requirement that the "the Code" is formally adopted as attached at Annex A and also the revised Treasury Management Policy Statement attached at Annex B.

14. The revised code has emphasised a number of key areas which have been taken into account in the Treasury Management Strategy and are highlighted as follows:
    a) All councils must formally adopt the revised Code and four clauses (paragraph 13 and Annex A and B)
    b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities (paragraph 12)

c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out (paragraph 50)
d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation (paragraph 71)
e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support (paragraph 57)
f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits (paragraph 57-63)
g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities (paragraph 34-36)
h) The main annual treasury management reports MUST be approved by full Council (paragraph 11)
i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved (paragraph 11)
j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body (paragraph 11)
k) Treasury management performance and policy setting should be subjected to scrutiny (paragraph 11)
l) Members should be provided with access to relevant training.
m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training (paragraph 73)
n) Responsibility for these activities must be clearly defined within the organisation (paragraph 73)
o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

15. This strategy statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy will be approved annually by full council and there will also be a mid year report. In addition there will be monitoring reports and regular review by Members in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

16. This Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code:

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Policy Statement (revised)	Full council	Initial adoption before the start of the financial year – February 2010
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full council	Annually before the start of the financial year – February 2010
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report and updates or revisions at other times	Full council	Mid year / Quarterly
Annual Treasury Outturn Report	Full council	Annually by 30 September after the end of the financial year
Treasury Management Monitoring Reports	Executive	Quarterly
Treasury Management Practices	Officers	Annually
Scrutiny of treasury management strategy	Audit & Governance Committee	Annually
Scrutiny of treasury management performance	Audit & Governance Committee	Quarterly

Table 1 – Reporting Arrangements

17. CIPFA Prudential Code has also been revised to include the requirement that where there is a significant difference between the net and gross borrowing position, the risks and benefits associated with this are clearly stated in the treasury management borrowing strategy. An additional change has also occurred when reporting prudential indicators –where the authorised limit and operational boundary and actual external debt indicators are now to be reported as Treasury Indicators rather than prudential Indicators. This is a minor amendment as all indicators are presented together as one suite.

18. It should also be noted that the Department of Communities and Local Government (DCLG) is currently undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities to come into effect from 1 April 2010. A separate report will be made to members to inform them when this guidance has been finalised. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code.

Balanced Budget Requirement

19. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:
    a. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
    b. any increases in running costs from new capital projects

    are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

Treasury Limits 20010/11 –2014/15

20. It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Borrowing Limit", and is the absolute maximum level of debt the Council is permitted to take. Within this limit there is an "Operational Borrowing Limit", which is the maximum level of debt allowed for on going operational purposes. In reality the operational limit would only be breached as a result of in year cash flow movements.

21. The Council must have regard to the Prudential Code when setting the Authorised and Operational Limits which essentially requires the Council to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'. Both the operational limit and authorised limit have been reviewed in light of the capital investment plans, as set out in the capital programme, and rebased for 20010/11. They now stand at £188.3m and £228.3m respectively.

22. The "Authorised Borrowing Limit" incorporates external borrowing and other forms of liability, such as credit arrangements. Both limits are set on a rolling basis for the forthcoming financial year and two successive financial years as set out in the Prudential Code. Details of the Authorised Limit can be found in Annex C of this report – Prudential Indicators 2010/11 to 2014/15

Prudential Indicators

23. The Council is required by regulation to have regard to the Prudential Code when carrying out its duties under the Local Government Act 2003. The key objectives of the Prudential Code are to ensure, within a clear framework, that local authorities' capital investment plans are affordable, prudent and sustainable; that treasury management decisions are taken in

accordance with good professional practice; and that local strategic planning, asset management planning and proper option appraisal are supported. Annex C illustrates the Prudential Indicators for the next 3 financial years, as required by the prudential Code, 2010/11 to 2014/15 with a description of what each indicator represents.

24. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. Full Council last adopted this on 21 February 2008 and the revised Code will be adopted by Full Council as part of this report on 25 February 2010.

25. The Prudential Indicators and adoption of the revised CIPFA Code of Practice on Treasury Management help drive the treasury management strategy and annual investment strategy. The effective management and control of risk are prime objectives of the Council's treasury management activities and the paragraphs below take account of all additional factors that need to be taken into consideration when formulating the treasury strategy.

Current Treasury Management Portfolio Position

26. The Council's current treasury portfolio position at 31 January 2010 is detailed below in Table 2:

Institution Type	Principal	Average Rate
Public Works Loan Board (PWLB) – Money borrowed from the Debt Mgt Office (Treasury Agency)	£98.065 m	4.217%
Market Loans Club Loan – A loan taken in conjunction with 2 other Authorities LOBO Loan – Lender Option Borrower Option	 £10.0m £5.0m	 7.155% 3.880%
Total Gross Borrowing	**£113.065**	**4.462%**
Total Investments	**£ 40.550**	**2.25%**
Net Debt	£ 72.515	

Table 2 – Current treasury portfolio position

27. The Council currently has £113.1m of fixed interest rate debt with an average life of loan of 20 years and average cost of debt of 4.46%. The Council currently has no variable rate borrowing. The Council is only permitted to borrow to invest in capital projects, unless permitted to do otherwise by the Government. Therefore the majority of the Councils existing debt is secured against its asset base.

28. Figure 1 shows the Councils current debt maturity structure as at 31 January 2010:

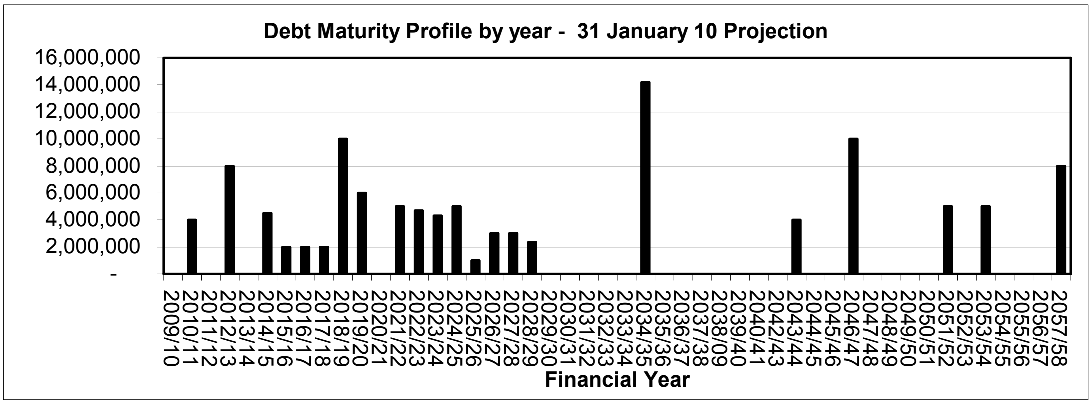

Figure 1 – Debt Maturity Profile as at January 2010

29. The Council's total investments at 31 January 2010 was £40.55m of which £7.05m were held in instant access call accounts with the remaining £33.50m being invested in fixed term deposits on the UK money market.

Prospects for Interest Rates

30. Current interest rates and the future direction of both long term and short term interest rates have a major influence on the overall treasury management strategy and affects both investment and borrowing decisions. To facilitate treasury management officers in making informed investment and borrowing decisions the Council contracts Sector Treasury Services as its treasury advisers. Part of their service is to assist the Council in formulating a view on interest rates. Annex D draws together a number of current forecasts for short term (Bank Rate) and longer fixed term rates. Sector Treasury Services central view on the Bank rate forecast for the following years is detailed below in Table 3:

Year	2009/10	2010/11	2011/12	2012/13
Rate	0.50%	1.50%	3.50%	4.50%

Table 3 – Sector's Bank Rate forecast

31. Sector Treasury services view of fixed long term borrowing rates (PWLB) and the base rate are also shown below in Figure 2.

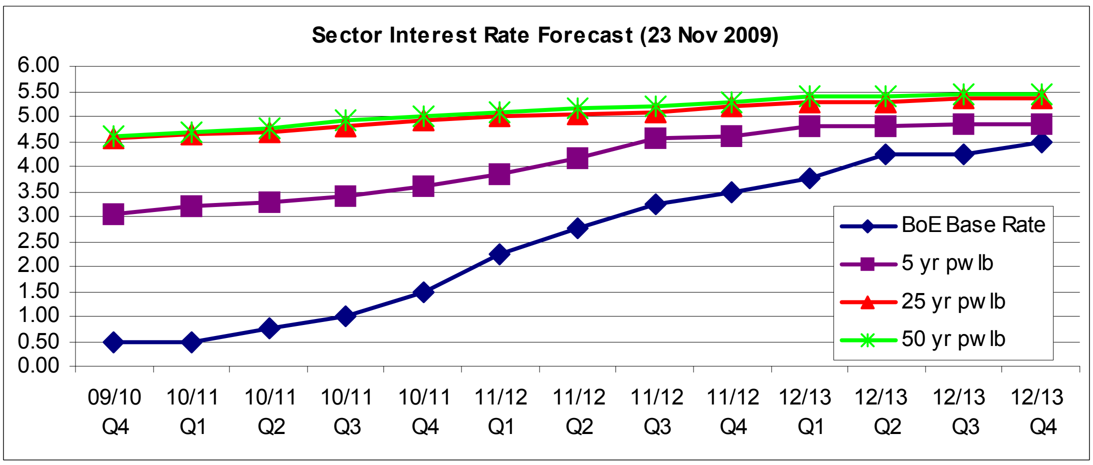

Figure 2 – Sector interest rate forecast

32. The graph clearly shows that the base rate and a range of PWLB borrowing rates are forecast to rise to between 4.5% and 5% in the foreseeable future. There is a downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

Economic Background

33. A detailed view of the current economic background is contained within Annex E and assists in the formulation of the treasury management strategy as it details the current economic and market environment.

Borrowing Strategy

34. Historically the Council has needed to borrow approximately £10m a year to finance its capital programme. This level of borrowing is the level at which the Government provide support through grant funding to cover the cost of interest payments and debt repayment. The Council intends to borrow above the level supported by Government grant funding in future years taking advantage of the Prudential Code (introduced April 2004) which allows Local Authorities to determine their own programmes for capital investment so long as the plans are affordable, prudent and sustainable.

35. The Financial Regulations currently delegate the approval of prudential borrowing less than £100k to the Director of Resources. The interest rate used is the Consolidate Rate of Interest on the loans portfolio. Executive currently approves the repayment period for all borrowing. In future, the Director of Resources should have full discretion to choose the length of the repayment period for all borrowing to ensure that borrowing matches the asset life. This will ensure value for money as it will allow prudential borrowing repayment periods to alter as asset life changes This is a day to day operational matter that should be delegated to the Director of Resources.

36. The main reason for the increase in unsupported borrowing to date is due to the delayed timing of capital receipts being received and large-scale investment in major assets that will result in long-term revenue savings to the Council. The key project is the Administrative Accommodation Rationalisation Project (£28m borrowing requirement)

37. As a result of the Capital programme 2010/11 to 2014/15 the borrowing requirement is projected to increase significantly from its current level of £113.1m in 2009/10 to £160.1m in 2014/15. The treasury management and borrowing strategy needs to reflect this position when considering the current economic and market environment. The Sector forecast for PWLB borrowing rates for future years is detailed below in table 4:

	Mar - 10	Jun - 10	Sep - 10	Dec - 10	Mar - 11	Mar - 12	Mar - 13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	3.50%	4.50%
5 yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	4.60%	4.85%
10 yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	5.00%	5.15%
25 yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.20%	5.35%
50 yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.30%	5.45%

Table 4 – Forecast of PWLB Borrowing Rates

38. In view of the above forecast the Council's borrowing strategy will be based upon the following information.

a) Rates are expected to gradually increase during the year so it should therefore be advantageous to time new long term borrowing for the start of the year when 25 year PWLB rates fall back to or below the central forecast rate of about 4.65%.
b) Variable rate borrowing is expected to be cheaper than long-term borrowing and will therefore be attractive throughout the financial year compared to taking long term fixed rate borrowing.
c) PWLB rates on loans of less than ten years duration are expected to be substantially lower than longer-term PWLB rates offering a range of options for new borrowing.
d) There is expected to be little difference between 25 year and 50 year rates so therefore loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This would maximise the potential for debt rescheduling and allow the Council to rebalance its debt maturity profile.
e) Fixed rate market loans at 25 – 50 basis points below the PWLB target rate offer the opportunity to maintain an appropriate balance between PWLB and market debt in the debt portfolio.

39. In light of these projections the proposed Council strategy is as follows:

a) With medium to long term borrowing (25 - 50 year PWLB) forecast to be between 4.5% and 5% during the year and shorter borrowing forecast to be lower than 4.5% a suitable trigger point for considering PWLB fixed rate borrowing would be 4.5%. Borrowing will be considered throughout the financial year in order to spread risk, although concentration will be focussed in the first few months of 10/11 as rates are forecast to rise during the year. Consideration will also be given to the maturity profile of the debt portfolio so the Council is not exposed to the concentration of debt being in any one year.
b) Variable rate borrowing is also expected to be cheaper than long-term borrowing and will therefore be considered during the year. It should be noted, however, that variable rate borrowing would only bring short-term benefit and increase the risk to the Council of refinancing debt at a future date when it is forecast for rates to be at a higher level.

c) Borrowing for the timing in shortfall of Capital receipts will be kept at the very short end - 1 or 2 years - in order to spread the interest rate cost over a number of years until budget pressures have eased and the capital receipt realised.
d) Consideration will also be given to not taking full level of borrowing required, in light of investment rates being lower than borrowing rates. The investment portfolio can be reduced and surplus funds used to support the capital borrowing requirement rather than new debt.

40. Caution in this approach will be adopted with the Director of Resources monitoring interest rates and ensuring a pragmatic approach is taken to changing circumstances reporting any decisions as part of the monitoring cycle.

41. The main sensitivities of the forecast are likely to be the two scenarios below. The Treasury Management team in conjunction with the treasury advisers, 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, due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

- if it were felt that there was a significant risk of a much sharper rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or 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

Policy on Borrowing in advance of need

42. Any decision to borrow in advance of need will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds. If Investment rates are higher than borrowing rates, the Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

43. The borrowing requirement is projected to increase significantly from its current level of £113.1m in 2009/10 to £160.1m in 2014/15 in line with the Capital programme Budget report 2010/11 to 14/15. Borrowing rates are forecast to rise in the future years in the current economic environment, whereas the level of investment rates are forecast to be lower.

44. Consideration will be given to borrowing in advance of need to seek to minimise the risk of being required to borrow a large amount of money in a

single year. The strategy therefore allows borrowing to be taken in advance of need if interest rates are at favourable levels or not to borrow until future years if borrowing rates remain above investment rates.

Policy on Gross and Net debt

45. The revised Prudential Code paragraph 43 now requires each authority to explain its policy on gross and net debt if there is a significant difference between them. This Council currently has a difference between gross debt (£113.1m) and net debt (£72.5m)(after deducting cash balances), of £40.6m.

Comparison of gross and net debt position at year end	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Probable	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Gross external debt		113.1	136.1	158.2	161.9
Cash balances		40.6	36.0	29.0	26.0
Net debt		**72.5**	**100.1**	**129.2**	**135.0**

Table 5 – Comparison of Gross and Net Debt

46. The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk (see paragraph 65) so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

47. The next financial year is expected to be one of historically abnormally low Bank Rate. Therefore consideration will be given to reducing the level of the investment portfolio to support the capital investment requirement, rather than taking on new external borrowing.

48. Over the next three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short-term savings. Table 4, still shows debt levels increasing, this is largely due to delay in capital receipts realised and the borrowing is therefore short term. It is expected that this borrowing can be taken at rates below investment rates available. If not, further internal borrowing will be considered.

49. That said, the benefits of short term savings by avoiding new long term external borrowing in 2010/11 will also be weighed against the potential for

incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

50. The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007 has meant that to date large premiums would be incurred by such action and would also do so in the near term; such levels of premiums may not be justifiable on value for money grounds. This situation will be monitored in case the differential is narrowed by the PWLB or when repayment rates rise substantially.

51. Against this background caution will be adopted with the 2010/11 treasury operations. The Director of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

Debt Rescheduling

52. The introduction of the new PWLB rates structure on 1 November 2007 that introduced a spread between the rates applied to new borrowing and repayment of debt, (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive for the Council than before that date. However, significant interest savings will still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans (note commercial markets are not currently fully operational thus decreasing the likelihood of debt restructures).

53. As short term borrowing rates will be considerably cheaper than longer-term rates, there maybe opportunities to generate savings by switching from long term debt to short-term debt. However, these savings will need to be considered in the light of their short-term nature, the costs of premiums involved and the likely cost of refinancing those short-term loans, once they mature.

54. The reasons for any rescheduling to take place will include:

a) the generation of cash savings and / or discounted cash flow savings;
b) helping to fulfil the strategy outlined in paragraph xx above, and
c) enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

55. There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised (downwards) in order to help local authorities currently dissuaded

from using investment cash balances to repay long term borrowing and thereby reduce counterparty and interest rate risk exposure. The Debt management office / PWLB have issued a consultation document with suggested options to revise the methodology used to calculate the early repayment rate. The consultation period ended in January 2010 and this authority will monitor developments in this area and may amend its strategy if significant changes are introduced

56. Any rescheduling will be reported in accordance with the usual monitoring cycle.

Investment Strategy

57. The Council will have regard to the department of Communities and Local Government's (DCLG) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments (which was reported in the Annual Outturn report 2008/09) and the 2009 CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

58. The Council's investment priorities are the security of capital and the liquidity of its investments. The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of it investments, see later in the section of the Creditworthiness Policy.

59. The borrowing of monies specifically to invest or lend on and make a return is unlawful and the Council will not engage in such activity.

60. Investment instruments identified for use in the financial year are listed in Annex F under the Specified and Non-Specified Investments categories. Counterparties limits will be as set through the Council's Treasury Management Practices Schedule. Consideration will be given throughout the year and approval requested where necessary to the alteration of the specified and non-specified investment categories to allow the continued effective management of the Councils treasury management operations. The Council continues to take a prudent approach to investing funds as set out in the Creditworthiness Policy below.

61. The Council's in-house funds are mainly cash flow derived. Investments will accordingly be made with reference to the core balance, cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). The Council uses matrices that stipulate both time and financial limits in order to spread counterparty (credit) risk when investing money with approved counterparties.

62. The market interest rate outlook for 2010/11 is based on the position of the Bank Rate. The Bank Rate has been unchanged at 0.50% since March

2009 but is forecast to commence rising in quarter 3 of 2010 and then to rise steadily from thereon. Bank rate forecast for the financial year-end are as follows: 2009/10 0.50%, 2010/11 1.50%, 2011/12 3.50% and 2012/13 4.50%. There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. The Council should therefore avoid locking into longer-term deals while investment rates are down at historically low levels, unless exceptionally attractive rates are available which make longer-term deals worthwhile.

63. For 2010/11 the Council has budgeted for an investment return of 1% on investments placed during the financial year. For its cash flow generated balances, the Council will seek to utilise short dated fixed term deposits along with instant access business reserve accounts (call accounts) in order to benefit from the compounding of interest.

64. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Creditworthiness Policy

65. This Council uses the creditworthiness service provided by Sector Treasury Services. 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
- CDS spreads to give early warning of likely changes in credit ratings
- Soverign ratings to select counterparties from only the most creditworthy countries

66. This modelling approach combines credit ratings, credit watches, credit outlooks and CDS (Credit Default Swap) spreads in a weighted scoring system for which the end product is a series of colour code bands, which indicate the relative creditworthiness of counterparties. These colour codes are also 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.

67. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. 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
- No colour not to be used

68. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue preponderance to just one agency's ratings.

69. All credit ratings will be monitored on an ongoing basis as information is provided weekly basis and also adhoc**.** 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.

70. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

71. 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). This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Minimum Revenue Provision (MRP) Policy Statement

72. Statutory Instrument 2008 no. 414 s4 explains that a local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent. This is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146, (as amended).

73. Along with the above duty, the Government issued new guidance in February 2008 which requires that a Statement on the Council's policy for

its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

74. The Council are legally obliged to “have regard” to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The four options are:

    a) The regulatory method – 4% of the borrowing outstanding;
    b) The Capital Financing Method – 4% of the Council’s Capital Financing Requirement;
    c) The Depreciation Method – repayment of the debt over its depreciation life;
    d) The Asset Life Method – repayment over the life of the asset to which the borrowing has been taken to fund.

75. Options a and b have broadly the same impact on the Council and the DCLG states are only used for the government supported borrowing. Option c would take the maximum repayment period to 40 years on operational land and buildings. Option d would take the maximum repayment period up to 60 years for some assets.

76. There are merits in adopting all the options, however, in terms of prudence it is recommended that the Council adopts option b for government supported borrowing and option d for unsupported borrowing, with a caveat that the asset life is an absolute maximum and wherever possible the debt should be repaid over a shorter period. To this end it is recommended that the standard repayment period should be up to 25 years or less if the asset life is shorter, unless approval is sought to extended the repayment provision over a longer period and a formal business case is made to the Executive to do so.

77. It should be noted that with all debts, the longer the repayment period the more is paid in interest over the period of the loan. It is therefore deemed as prudent to reduce the period over which the repayments are made.

Policy on use of External Service providers

78. The Council uses Sector Treasury Services as its external treasury management advisers.

79. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

80. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Scheme of Delegation and the Role of the Section 151 Officer

81. Those charged with governance are responsible for the treasury management activities and these need to be clearly defined within the organisation. Attached at Annex G are the Treasury Management Scheme of Delegation and also the Treasury Management role of the section 151 officer (the Director of Resources).

Corporate Priorities

82. The Treasury Management Strategy Statement and Prudential Indicators are aimed at ensuring the Council maximises its return on investments and minimises the cost of its debts, to allow more resources to be freed up to invest in the Council's priorities, values and imperatives, as set out in the Corporate Strategy.

Implications

- **Financial** – The revenue implications of the treasury strategy are set out in the Revenue Budget report on this agenda.
- **Human Resources (HR)** – None
- **Equalities** – None
- **Legal** – Complying with the Local Government Act 2003
- **Crime and Disorder** – None
- **Information Technology (IT)** – None
- **Property** – None

Risk Management

83. The treasury management function is a high-risk area because of the volume and level of large money transactions. As a result of this the Local Government Act 2003 (as amended), the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice (the code) are all adhered to as required. The Prudential Indicators, adopted 4 Clauses of "the Code" and the treasury management policy statement are all attached at Annex A, B and C respectively.

Recommendations

84. The Executive are asked to recommend that Council approve:

    a. The proposed Treasury Management Strategy for 2009/10
    b. The Prudential Indicators for 2009/10 to 2013/14 (Annex C);
    c. The revised CIPFA Treasury Management Code of Practice 2009 “the Code” and revised Treasury Management Policy Statement (Annex A & B)
    d. The Specified and Non-specified investments schedule (Annex F)
    e. The Scheme of Delegation and the Role of the Section 151 Officer (Annex G)
    f. The Financial Regulations be amended to give delegated authority to the Director of Resources to have full discretion to choose the length of the repayment period for all prudential borrowing as set out in paragraph 35.
    g. The Treasury Management Reporting arrangements set out in paragraph 16, table 1, as described by “the Code” and the terms of reference in the Constitution be amended to include that Audit & Governance Committee scrutinise the Treasury Management Strategy and Monitoring reports

85. **Reason**: To enable the continued effective operation of the Treasury Management function and ensure that all Council borrowing is prudent, affordable and sustainable.

Contact Details

Author:	**Chief Officer Responsible for the report:**		
	Ian Floyd Director of Resources		
Louise Branford-White Technical Finance Manager Corporate Accountancy Tel No. 551187	**Report Approved** Ian Floyd Director of Resources		**Date** 03/02/10
Ross Brown Corporate Accountant Corporate Accountancy Tel No. 551207	**Report Approved**	Y	**Date** 03/02/10

Specialist Implications Officer(s)

N/a

Wards Affected: **All** Y

For further information please contact the author of the report

Background Papers
2009/10 monitoring workings
Prudential Indicator Workings 09/10 – 13/14
Treasury Management budget 10/11
Capital Budget Control 09/1008/09.
Sector Treasury Services -Treasury Management Advisers Commentary.

Annexes
Annex A – Revised CIPFA Treasury Management Code of Practice 2009
Annex B – Treasury Management Policy Statement
Annex C – Prudential Indicators 2009/10 – 2013/14
Annex D – Prospects for Interest Rates
Annex E – Economic Background
Annex F – Specified and Non-Specified Investments categories Schedule
Annex G – Scheme of Delegation and the Role of the Section 151 Officer