Executive **15 February 2011**

Report of the Director of Customer and Business Support Services

Treasury Management Strategy Statement and Prudential Indicators for 2011/12 to 2015/16

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
   - Revised Treasury Management Policy Statement
   - Specified and Non-specified investments schedule
   - 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, including an investment 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 £136.1m in 2010/11 to a high of £182.1 over the next 5 years. 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 years, and seeks to maximise the returns to the Council whilst minimising the risks involved in placing deposits on the money market.

Background

Statutory requirements

5. The Local Government Act 2003 and supporting regulations 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.

6. As part of the strategy, the Local Government Act 2003 and supporting regulations also requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators 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 2011/12 to 2015/16 report and the revenue implications of these that are reflected in the revenue budget report, both presented to Full Council on 24 February 2011.

7. The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

CIPFA requirements

8. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 25 February 2010.

9. The primary requirements of the Code are as follows:
   a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities. This was adopted and approved at Full Council on 25 February 2010.
   b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
   c) Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. This Council approved the delegated body as the Audit & Governance Committee on 25 February 2010.

10. The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the Director of Customer & Business Support Services views on interest rates, supplemented with market forecasts provided by Sector Treasury Services, the Council's treasury management advisor. The strategy covers:

- Balanced Budget Requirement
- Treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential Indicators
- Current treasury position Prospects for interest rates Economic Background
- Borrowing strategy
- Policy on Borrowing in advance of need
- Policy on gross and net debt
- Debt rescheduling
- Investment Policy
- Creditworthiness Policy
- Investment Strategy
- Minimum Revenue Provision strategy
- Policy on external advisers
- Scheme of Delegation / Role of the Section 151 Officer

Balanced Budget Requirement

11. 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.

12. For 2011/12 the treasury management revenue budget will rise by £1,131k to £12,867 from £11,736k in 2010/11. This rise is predominantly due to an increase in interest paid on borrowing in line with the capital investment requirements of the capital programme. There is little impact on the

budget from the principal repayments of debt known as the minimum revenue provision. This is calculated in accordance with the minimum revenue provision policy statement detailed later in this report. The forecast of interest to be earned in 2011/12 remains low in the historically low investment interest rate environment.

Treasury Limits 20010/11 –2014/15

13. 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 represents the legislative limit specified in the Act. Within this limit there is an "Operational Boundary", 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.

14. 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 authorised limit and operational limit have been reviewed in light of the capital investment plans, as set out in the capital programme, and rebased for 2011/12. They now stand at £222m and £202m respectively.

15. The "Authorised Borrowing Limit" incorporates external borrowing and other forms of liability, such as credit arrangements. Both the Authorised Borrowing Limit and Operational Boundary 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 these limits can be found in Annex A of this report – Prudential Indicators 2011/12 to 2015/16

Prudential and Treasury Indicators 2011/12 to 2015/16

16. Prudential and Treasury Indicators attached at Annex A are required under legislation for the purposes of setting an integrated treasury management strategy.

17. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised 2009 Code was adopted by the full council on 25 February 2010.

Current Treasury Management Portfolio Position

18. The Council's current treasury portfolio position at 31 January 2011 is detailed below in Table 1:

Institution Type	Principal	Average Rate
Public Works Loan Board (PWLB) – Money borrowed from the Debt Mgt Office (Treasury Agency)	£111.1m	4.07%
Market Loans Club Loan – A loan taken in conjunction with 2 other Authorities LOBO Loan – Lender Option Borrower Option Local Authority Loan – One year	 £10.0m £10.0m £5.0m	 7.155% 3.74% 0.70%
Total Gross Borrowing	**£136.065**	**4.148%**
Total Investments	**£ 58.900**	**1.18%**
Net Debt	£ 77.165	

Table 1 – Current treasury portfolio position

19. The Council currently has £136.1m of fixed interest rate debt with an average life of loan of 19 years and average cost of debt of 4.148%. 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.

20. Figure 1 shows the Councils current debt maturity structure as at 31 January 2011:

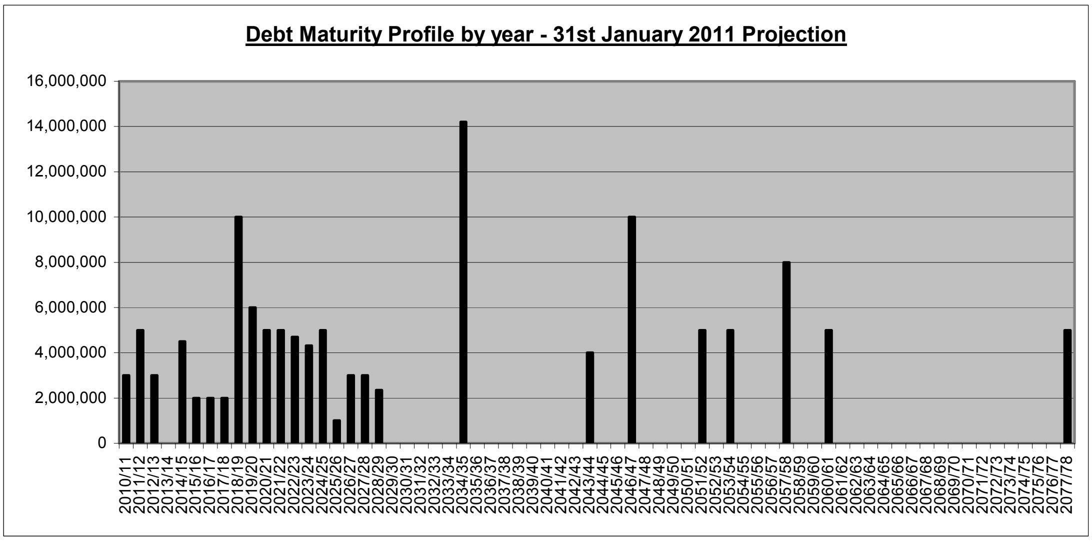

Figure 1 – Debt Maturity Profile as at January 2011

21. The Council’s total investments at 31 January 2011 was £58.9m of which £17.1m were held in instant access call accounts, £17.9m in instant access money market funds and £23.9m invested in fixed term deposits on the UK money market.

Prospects for Interest Rates

22. 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 advisor. Part of their service is to assist the Council in formulating a view on interest rates. Annex B draws together a number of current forecasts for short term (Bank Rate) and longer fixed interests rates. Table 2 gives Sector Treasury Services Bank Rate forecast:

Year	2010/11	2011/12	2012/13	2013/14
Rate	0.50%	1.00%	2.25%	3.25%

Table 2 – Sector's Bank Rate forecast for financial year ends

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

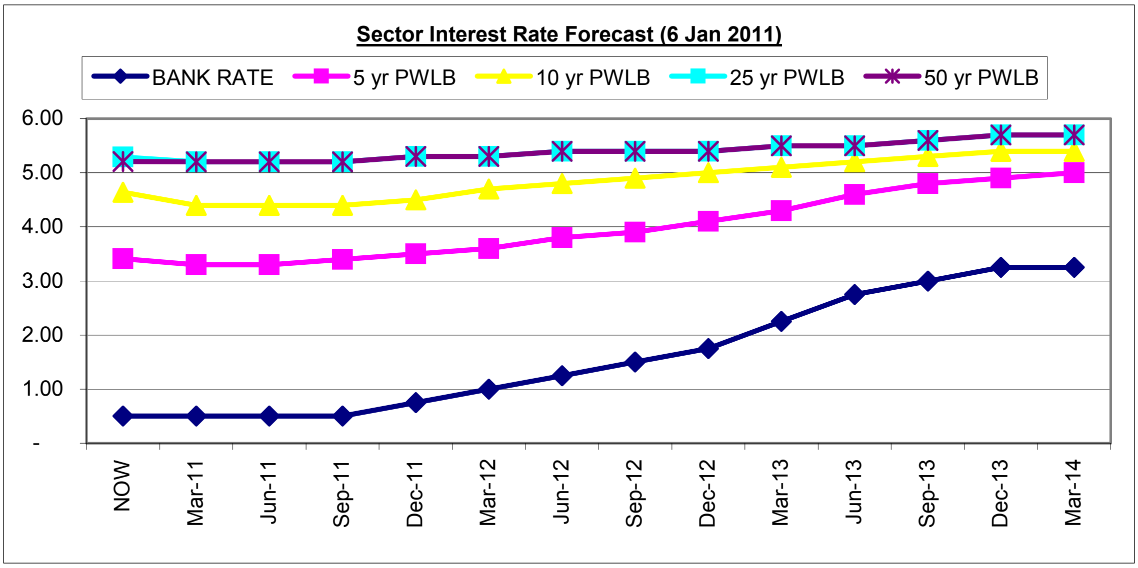

Figure 2 – Sector interest rate forecast

24. The graph clearly shows that the base rate and the range of PWLB borrowing rates are forecast to rise in the foreseeable future. Borrowing rates in 2011/12 are between 3.30% and 5.30%, they then rise at the end of 2013/14 to between 5% and 6%. There is a downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

Economic Background

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

Borrowing Strategy

~~26.~~ The Council undertakes long term borrowing in accordance with the investment requirements of the capital programme. The council's borrowing is described as either "supported" or "prudential". If borrowing is funded by the Government through the Revenue Support Grant (RSG), which provides the Council with revenue funding to allow it to meet the interest and repayment costs of borrowing, this is known as supported borrowing. If the Council borrows without Government support, under the Prudential Code, Councils are free to borrow up to a level that is deemed prudent, affordable and sustainable and within their prudential indicator limits. This is known as prudential borrowing.

27. In 2011/12, under the Comprehensive Spending Review borrowing ceased to be "supported" by the Government through RSG. Therefore, as it currently stands in future all borrowing is of a prudential nature as in accordance with Council's priorities and it has to be affordable, sustainable and prudent. It is estimated that the capital financing requirement in 2011/12 will be around £20m. This includes projects such as the Administrative Accommodation Rationalisation Project, the pools strategy, West of York Recycling site, Community Stadium, Highways resurfacing & reconstruction, assisting in independent living etc., more detail is found in the capital programme budget report 2011/12 to 2015/16 also included on this Executive agenda.

28. As a result of the Capital programme 2011/12 to 2015/16 the borrowing requirement is projected to increase significantly from its current level of £136.1m in 2010/11 to a high of £182.1 over the next 5 years. 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 3:

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	4.30%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	5.10%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%

Table 3 – Forecast of PWLB Borrowing Rates

29. The borrowing strategy is influenced by the above interest rate forecast. The interest rate forecast shows that borrowing rates are estimated to rise substantially over the next 3 years and the base rate, although rising, remains at historically low levels and below the borrowing rates.

Therefore, the borrowing strategy will be to lock into some long term borrowing in 2011/12 whilst interest rates are lower than in the coming years, but also give consideration to running down the investment portfolio as this is currently the cheapest form of borrowing. This balanced strategy will assist in stabilising the treasury management budget in future years but also allow the flexibility to utilise the changing interest rate environment to the best opportunity for the Council.

30. The Council's borrowing strategy is based on the following opportunities:

a) The cheapest form of borrowing will be internal borrowing which is the running down of surplus cash balances cash balances. This foregoes the interest that would have been earned at historically low rates on investments but saves the interest that would have been paid on higher borrowing rates. That said, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential longer term costs of the opportunity missed for taking loans at long term rates which will be higher in future years. However, there remains volatility in the market so favourable rates should still be available.
b) Temporary borrowing from the money markets or other local authorities
c) PWLB variable rate loans in the short term for up to 10 years
d) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
e) PWLB borrowing for periods under 10 where rates are expected to be significantly lower than rates for longer periods.

31. External borrowing will be taken throughout the financial year when interest rates seem most favourable. A target interest rate in light of table 3 above is 5%. 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.

32. External 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.

33. Caution in this approach will be adopted by the Director of Customer & Business Support Services (Section 151 Officer), the interest rate market will be monitored and a pragmatic approach adopted to changing circumstances, reporting any decisions as part of the monitoring cycle.

34. 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

35. The Council will not borrow “in advance of” or “more than” its need, purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance of need will be considered carefully in accordance with the capital programme to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

36. In determining whether borrowing will be undertaken in advance of need the Council will:
    a) ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
    b) ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
    c) evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
    d) consider the merits and demerits of alternative forms of funding
    e) consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
    f) consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them

37. The borrowing requirement is projected to increase significantly from its current level of £136.1m in 2010/11 to £182.1m over the next 5 years in line with the capital programme budget report 2011/12 to 2015/16. 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.

38. 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

39. The revised Prudential Code 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, £136.1m, and net debt, £111.1m, (after deducting cash balances), of £25.0m.

Comparison of gross and net debt position at year end							
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
	Actual	Probable	Estimate	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Gross external debt	116.1	136.1	179.6	182.1	176.1	172.5	169.0
Cash balances	25.9	25.0	30.0	30.0	30.0	30.0	30.0
Net debt	**90.2**	**111.1**	**149.6**	**152.1**	**146.1**	**142.5**	**139.0**

Table 4 – Comparison of Gross and Net Debt

40. The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years, (taking into account the forecast of interest rates) in order to reduce the credit risk incurred by holding investments. Important factors to consider are the (i) forecast of interest rates and (ii) the difference between borrowing rates and investment rates. This will ensure the Council obtains "value for money" once an appropriate level of risk management has been attained to ensure the security of its investments.

41. The next financial year is again expected to be one of historically abnormally low Bank Rate. Therefore, over the next three years, investment rates are expected to be below long term borrowing rates and consideration will be given to reducing the level of the investment portfolio to support the capital investment requirement. This would maximise short-term savings.

42. However, the benefits of short term savings by avoiding new long term external borrowing in 2010/11 will also be analysed against the potential for incurring additional extra costs in the long term from delaying unavoidable new external borrowing in later years when PWLB long term rates are forecast to be higher.

43. The Council continues to examine 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, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has potentially meant that large premiums would be incurred by such action; such levels of premiums are unlikely to be justifiable on "value for money grounds". This situation will continued to be monitored in case these differentials are narrowed by the PWLB at some future date.

44. Against this background caution will be adopted with the 2011/12 treasury operations. The Director of Customer Business and Support Services (S151 officer) 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

45. Prior to November 2007, it was often advantageous to reschedule one Public Works Loans Board (PWLB) loan for another PWLB loan, in order to make a saving on the Council's budget. However, since then, with the PWLB introducing a spread between the interest rates "applied" to new borrowing and repayment of debt and the affects of the Comprehensive Spending Review on 20 October 2010 - a considerable further widening of the difference between new borrowing and repayment rates - restructuring PWLB to PWLB debt is now much less attractive.

46. In particular, consideration has to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. Some interest savings might still be achievable through using LOBO (Lenders Option Borrowers Option) market loans (or other market loans) in rescheduling exercises, rather than using PWLB borrowing as the source of replacement financing.

47. 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.

48. 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 above, and
c) enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

49. Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

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

Investment Policy

51. The Council will have regard to the department of Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") and the 2009 CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

52. 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.

53. 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.

54. In accordance with "the Guidance" it is necessary in the strategy to determine investment instruments which are identified for use in the financial year. The investment instruments are classed under "specified" and "non-Specified" investments categories and are detailed in Annex D. It is also a requirement to set limits for the institutions in which the Council will invest their surplus funds - Counterparties limits. These are set out in the later section - the Investment Strategy.

55. 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.

Creditworthiness Policy

56. 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, which forms the core element. 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
- sovereign ratings to select counterparties from only the most creditworthy countries

57. 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.

58. 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*:*
    - Yellow 5 years
    - 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

59. 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.

60. 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.

61. 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.

62. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex E. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Investment Strategy

63. 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. The matrices are based on the projected average balance for the year. Therefore for 2011/12 (as for 2010/11) with the average balance forecast to be circa £60m, the matrix stipulates a limit for £8m for counterparties with a durational band of 3 months and £15m longer than 3 months.

64. 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 4 of 2011 and then to rise steadily from thereon. Bank rate forecast for financial year-end (March) are: 2009/10:0.5%, 2010/11:1.5%, 2011/12:3.5%, 2012/13:4.5%

65. There is downside risk to these forecasts economic growth is weaker than expected. There is also a risk that the MPC could decide to start raising Bank Rate in quarter 3 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public.

66. The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this council.

67. For 2011/12, in the current economic environment, the Council has budgeted for an investment return target of 1.5% 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) and money market funds in order to benefit from the compounding of interest.

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

Minimum Revenue Provision (MRP) Policy Statement

69. Statutory Instrument (SI) 2008 no.414 s4 explains that a local authority shall determine for the current financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This SI is an amendment and stands along side the previous requirement to comply with regulation 28 in SI 2003 no.3146. In accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003, 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.

70. 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.

71. Options a and b have broadly the same impact on the Council and the DCLG states are only used for the government supported borrowing, which mainly relates to the more historic debt liability. 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.

72. There are merits in adopting all the options, however, in terms of prudence it is recommended that the Council adopts option a 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. Estimated asset life periods will be determined under delegated powers. 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 Director of Customer & Business Support Services.

73. 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

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

75. 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.

76. 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

77. Those charged with governance are responsible for the treasury management activities and these need to be clearly defined within the organisation. Attached at Annex F are the Treasury Management Scheme of Delegation and also the Treasury Management role of the section 151 officer (Director of Customer & Business Support Services).

Consultation and Options

78. 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 Director of Customer & Business Support Services, 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.

79. 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.

~~80.~~ At a strategic level, there are a number of treasury management options available which depend on the Council's stance on interest rate movements. The report sets out the Council's stance and recommends the setting of key trigger points for borrowing and investing over the forthcoming financial year.

Corporate Priorities

81. 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. This will 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 also on this agenda.
- **Human Resources (HR)** – None
- **Equalities** – None
- **Legal** – Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England**)** (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.
- **Crime and Disorder** – None
- **Information Technology (IT)** – None
- **Property** – None

Risk Management

82. 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), supporting regulations, the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice (the code) are all adhered to as required.

Recommendations

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

    a. The proposed Treasury Management Strategy for 2011/12 including the annual investment strategy and the minimum revenue provision policy statement;
    b. The Prudential Indicators for 2011/12 to 2015/16 (Annex A);
    c. The Specified and Non-specified investments schedule (Annex D)
    d. The Scheme of Delegation and the Role of the Section 151 Officer (Annex F)

84. **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

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Specialist Implications Officer(s)
N/a

Wards Affected: **All** √

For further information please contact the author of the report

Background Papers
2010/11 monitoring workings
Prudential Indicator Workings 2010/11 to 15/16
Treasury Management budget 2011/12
Capital Budget Control 2010/11 to 2015/16.
Sector Treasury Services -Treasury Management Advisers Commentary.

Annexes
Annex A – Prudential and Treasury Indicators 2010/11– 2015/16
Annex B – Interest Rate Forecast
Annex C – Economic Background
Annex D – Specified and Non-Specified Investments categories Schedule
Annex E – Approved countries for investments
Annex F – Scheme of Delegation and the Role of the Section 151 Officer