

<b>DECISION-MAKER:</b>	AUDIT COMMITTEE COUNCIL		
<b>SUBJECT:</b>	ANNUAL TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2009/10-2012/13		
<b>DATE OF DECISION:</b>	25 <sup>TH</sup> JANUARY 2010 17 <sup>TH</sup> FEBRUARY 2010		
<b>REPORT OF:</b>	EXECUTIVE DIRECTOR OF RESOURCES		
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### STRATEGY OF CONFIDENTIALITY

NOT APPLICABLE

### SUMMARY

Treasury Management is a complex subject and the majority of this report is set out in accordance with statutory requirements and guidance issued by the Chartered Institute of Public Finance and Accountancy. The information provided is therefore mainly technical but in essence this information forms the basis of the Treasury Management Strategy and Objectives that are being followed even if these are not spelt out in simple terms. The purpose of this summary therefore is to interpret this information in such a way that provides Members with key messages on the approach to Treasury Management within the Council.

The core elements of the strategy for 2010/11 are :-

- To continue the use of variable rate debt to take advantage of the current market conditions
- To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year in order to provide a balanced portfolio against interest rate risk
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio
- To maximise investment returns in line with the Annual Investment Strategy and to constantly monitor global markets to protect the security of our investments.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.

In essence treasury management can always been seen in the context of the classic 'risk and reward' scenario and by following this strategy this will contribute to the Council's wider Treasury Management objective which is to minimise net borrowing cost in the short term without exposing the Council to undue risk either now or in the longer term.

The minimisation of net borrowing costs contributes to the Council's priority for providing efficient value for money services and active treasury management can help in lessening the impact of the economic recession on the City Council which has been demonstrated through the restructuring of the debt and investment portfolio that was undertaken early in 2009. This also demonstrates that the Council takes a rounded view to Treasury Management, considering jointly the debt and investment portfolio together rather than one being the consequence of activity in the other.

The Council can also demonstrate integrated thinking through work that it has been doing on balance sheet analysis and forecasting and working with our advisors on potential changes to HRA subsidy and debt arrangements. The Council is also very cognisant of requirements of accounting conventions and changes relating to IFRS, but these do not drive treasury management decisions which has been demonstrated by the decision to undertake a major restructuring which then caused huge complexities in representing this in the accounts in line with accounting conventions.

There are huge number of variables and risks associated with Treasury Management but the key risks and the Council's approach to them are detailed below :-

- **Interest Rate Risk** – The Council has exposed itself to interest rate risk by taking out variable debt during 2009. This was and continues to be very financially favourable in current markets but does mean that the Council must monitor markets to ensure it is not caught out. During 2010/11, therefore the Council will almost certainly start to take action to lessen this risk through a balanced combination of :-
  - longer term fixed maturity loans,
  - medium term Equal Instalment of Principle (EIP) loans (which are currently cheaper than longer term fixed) and
  - longer term PWLB variable loans which have the option to be fixed at very short notice for a small fee.
  - Variable rate investments to take advantage of increasing interest rates
  
- **Investment Risk** – The risks to capital investment are more known now than they have ever been and the Council has a good track record in respect of appropriate risk exposure during the global economic crisis of recent years. Current investment limits and instruments have been set in the context of current conditions and will continue to be monitored and amended as appropriate.
  
- **Changes in Market Conditions** – The Council must be able to react quickly to changes in market conditions either good or bad and all Treasury Management decisions are taken by the Chief Financial Officer in line with the strategy. In addition, decision sheets are signed off by the CFO that contain 'trigger points' for market changes which can then automatically be actioned at short notice without the need to get formal sign off on the day. Furthermore, in response to the recent financial turmoil, this report recommends that the CFO be given delegated authority to make any changes to this strategy that will aid good treasury management. Any decisions made under this power will be reported in full at a later date.

Furthermore, in order to mitigate these risks further, the Council has taken the

opportunity in the current year to use the savings created by the debt restructure (around £1.5M) to create a treasury management equalisation reserve which will be available to smooth any significant fluctuations in market conditions in future years, so that there is no adverse impact on budgets or council tax in any single year.

In this report, Council is requested to approve the Prudential Indicators and the Treasury Management Strategy and to note the main activities undertaken during 2009/10 to date which are summarised below:

- (i) Investment returns have decreased from £3.7M in 2008/09 to an estimated £1M in current year as a result of a fall in interest rates. The average rate achieved to date (0.88%) is above the performance indicator of the average 7 day Libid rate (0.59%).
- (ii) In order to balance the fall in investment income we have switched to short term debt which is currently lower than long term due to the depressed market. As a result the average rate for repayment of debt has reduced from 4.15% in 2008/09 to 3.18%. As this is a temporary arrangement any savings are to be transferred to the debt equalisation reserve until we lock back into long term debt. It should be noted that the forecast for longer term debt is a steady increase over the next few years so new long term borrowing will be taken out above this rate, therefore an increase in the Consolidated Rate of interest should be expected.
- (iii) In order to comply with the revised CIPFA code for Treasury Management training for members was undertaken by an independent company recommended by our advisors (Arlingclose) on the 10<sup>th</sup> December 2009.

The estimates for interest payable and the Prudential Indicators contained within this report assume that the recommendations in the Capital and Revenue budget reports, elsewhere on the agenda, are approved. If there are any changes to the capital programme or the level of borrowing the Prudential Indicators will need to be revised.

## **RECOMMENDATIONS:**

### **Audit Committee is recommended to**

- (i) Endorse the Treasury Management Strategy for 2010/11 as outlined in the report; and
- (ii) To note that the indicators as reported have been set on the assumption that the recommendations in the Capital Update report will be approved. Should the recommendations change, the Prudential Indicators may have to be recalculated.
- (iii) Note that due to the early timing of this report, changes may still be required following the finalisation of capital and revenue budgets and therefore any significant changes to this report will be highlighted in the final version that is presented to Full Council.

### **Council is recommended to**

- (i) Approve the Council's Prudential Indicators as detailed within Appendix 2.

- (ii) Approve the 2010 MRP Statement.
- (iii) Approve the Treasury Management Strategy for 2010/11 as outlined in the report; and
- (iv) To note that the indicators as reported, have been set on the assumption that the recommendations in the Capital Update report will be approved. Should the recommendations change, the Prudential Indicators may have to be recalculated.
- (v) To approve amendments to Standing Orders to comply with the revised CIPFA guide on Treasury Management as detailed in paragraph 7.
- (vi) To delegate authority to the Executive Director of Resources following consultation with the Cabinet Member for Resources and Workforce Planning to approve any changes to the Prudential Indicators or borrowing limits that will aid good treasury management, for example increase the % for variable rate borrowing to take advantage of the depressed market for short term rates. Any amendments will be reported as part of quarterly financial and performance monitoring and in revisions to this strategy.

## **REASONS FOR REPORT RECOMMENDATIONS**

1. In order to comply with Part 1 of the Local Government Act 2003, and the established treasury management procedures that have been adopted by the Authority, each year the Council must set certain borrowing limits and approve a treasury management strategy which includes:
  - Treasury Management Strategy for 2010-11 (Borrowing; paragraphs 18-34, Debt Rescheduling; paragraphs 39-43, Investments; paragraphs 44-58)
  - Prudential Indicators – Appendix 2 (NB - The Authorised Limit is a statutory limit)
  - MRP Statement – paragraphs 60-65
  - Use of Specified and Non-Specified Investments – Appendix 4

## **CONSULTATION**

2. The proposed capital and revenue budgets on which this report is based have been subject to their own consultation processes outlined in the relevant reports elsewhere on the Council agenda.

## **ALTERNATIVE OPTIONS CONSIDERED AND REJECTED**

3. Alternative options for borrowing would depend on decisions taken on the setting of the capital programme, which are being taken at Full Council on 17<sup>th</sup> February 2010.

## **DETAIL**

### **Background**

4. The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as

their capital spending plans are affordable, prudent and sustainable.

5. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS). This statement also incorporates the Investment Strategy. Together, these cover the financing and investment strategy for the forthcoming financial year.
6. In response to the financial crisis in 2008 and the collapse of the Icelandic banks, CIPFA has revised the TM Code and Guidance Notes as well as the Prudential Indicators. Communities and Local Government (CLG) is also in the process of revising and updating the Investment Guidance. Changes required to be made to this Strategy and/or documentation will be placed before members for consideration.
7. As part of the review CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.
  1. This organisation will create and maintain, as the cornerstones for effective treasury management:
    - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
    - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. This organisation (ie full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Audit Committee and for the execution and administration of treasury management decisions to the Chief Financial Officer who will act in accordance with the organisation's policy statement and TMPs and, as she is a CIPFA member, CIPFA's *Standard of Professional Practice on Treasury Management*.
4. This organisation nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

In order to ensure compliance with this recommendation, the TMSS will now be presented to the Audit Committee before going to full Council for approval. Training for Audit Committee members has taken place in order to enable them to undertake their review of TMSS. However it should be noted that given the timing of the meetings the figures in the Audit Committee report are only provisional and will be subject to change dependent on final decisions made by Council for the capital and revenue budgets.

8. CIPFA has defined Treasury Management as:

“the management of the organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

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 is the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council. The main risks to the Council’s treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels and thereby in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

9. 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. To aid the Council in carrying out its Treasury Management function, it has appointed Treasury Management Advisors (Arlingclose) who advise the Council on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the Chief Financial Officer taking into account this advice and other internal and external factors. A good example of this was the decision by the CFO to only use the Debt Management Office for investments at the time of the Icelandic Bank crisis, despite our advisors saying that other institutions could still be used at the time. A week later our advisors changed their view in line with what the council had already implemented.

10. The Council’s proposed strategy for 2009/10 - 2012/13 also takes into account the outlook for interest rates (see Appendix 3), its current treasury position, its

projected treasury management and capital financing activities and its approved Prudential Indicators as detailed in Appendix 2.

### **Balance Sheet and Treasury Position**

11. 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 set out below:

	<b>31-Mar-10</b>	<b>31-Mar-11</b>	<b>31-Mar-12</b>	<b>31-Mar-13</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
CFR	282	306	302	295
Balances & Reserves	30	25	25	25
<b>Net Balance Sheet Position</b>	<b>252</b>	<b>281</b>	<b>277</b>	<b>270</b>

12. The Council's level of physical debt and investments is linked to these components of the Balance Sheet. The current portfolio position is set out at Appendix 1. 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.
13. As the CFR represents the level of borrowing for capital purposes and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of its invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements.
14. The move to International Financial Reporting Standards (IFRS) has implications for the Capital Financing Requirement components on the Balance Sheet. Analysis of the Council's Private Finance Initiative (PFI) schemes and Operating leases against IFRS requirements may result in the related long term assets and liabilities being brought onto the Council's Balance Sheet. The estimates for the CFR and Long Term Liabilities will therefore need to take into account such items. This will influence the determination of the Council's Affordable Borrowing Limit and Operational Boundary.
15. The Department for Communities and Local Government has recently consulted on proposals to reform the council housing subsidy system. The proposed Self-financing option would require a one-off reallocation of housing

debt. As the consultation period has only recently ended and the mechanism for debt transfer has not been determined, the estimates set out in this strategy do not take into account any potential debt transfer that may arise in future years.

16. The estimate for interest payments in 2010/11 is £6.1m and for interest receipts is £0.6m.

#### **Outlook for Interest Rates**

17. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix 3. Financial markets remain reasonably volatile as the structural changes necessary within economies and the banking system evolve. This volatility provides opportunities for active treasury management. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

#### **Borrowing Requirement and Strategy**

18. The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) as detailed in Appendix 2. The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.
19. Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR (the underlying need to borrow) and in turn produce an increased requirement to charge MRP in the Revenue Account.
20. Physical external borrowing may be greater or less than the CFR, but in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.
21. The cumulative estimate of the maximum long-term borrowing requirement is estimated by comparing the projected CFR with the profile of the current portfolio of external debt and long term liabilities over the same financial horizon, as follows:



	31/03/2010 Estimate £m	31/03/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m
<b>Capital Financing Requirement</b>	282	306	302	295
<b>Less:</b>				
Existing Profile of Borrowing and Other Long Term Liabilities	217	247	244	238
<b>Cumulative Maximum External Borrowing Requirement</b>	65	59	58	57
Balances & Reserves	30	25	25	25
<b>Cumulative Net Borrowing Requirement/Investments</b>	35	34	33	32

22. The Council's strategy is to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. 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. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

23. Therefore, in conjunction with advice from its treasury advisors, the Council will keep under review the options it has in borrowing from the Public Works Loan Board (PWLB) and from market and other sources identified in the Treasury Management Practices Schedules up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

***The outlook for borrowing rates:***

24. Short-dated gilt yields are forecast to be lower than medium- and long-dated gilt yields during the financial year. Despite additional gilt issuance to fund the UK government's support to the banking industry; short-dated gilts are expected to benefit from expectations of lower interest rates as the economy struggles through a recession. Yields for these maturities will fall as expectations for lower interest rates mount.

25. The differential between investment earnings and debt costs, despite long term borrowing rates being around historically low levels, remains acute and this is expected to remain a feature during 2010/11. The so-called "cost of carry" associated with long term borrowing compared to temporary investment returns means that the appetite for new long term borrowing brings with it additional short-term costs. It is not surprising that the use of internal resources in lieu of borrowing has been the most cost effective means of financing capital expenditure but, at some stage, internal resources will

- become depleted and require topping up.
26. PWLB variable rates have fallen below 1%. They are expected to remain low as the Bank Rate is maintained at historically low levels to enable the struggling economy to emerge from the recession. Against a backdrop of interest rates remaining lower for longer and a continuation of the cost of carry backdrop, then a passive borrowing strategy i.e. borrow long term funds as they are required may remain appropriate. Equally, variable rate funds (that avoid the cost of carry) or EIP (equal instalments of principal) that mitigate the impact are both active considerations.
  27. Decisions to borrow at low, variable rates of interest will be taken after considering the absolute level of longer term interest rate equivalents and the extent of variable rate earnings on the Council's investment balances. When longer term rates move below the cost of variable rate borrowing any strategic exposure to variable interest rates will be reviewed and, if appropriate, reduced.
  28. The PWLB remains the preferred source of borrowing given the transparency and control that its facilities continue to provide.
  29. The Council has £9m loans which are LOBO loans (Lender's Options Borrower's Option) of which are currently in their option state. In the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB.
  30. Actual borrowing undertaken and the timing will depend on capital expenditure levels, interest rate forecasts and market conditions during the year, in order to minimise borrowing costs. The Council will be advised by its financial advisors of the specific timing of borrowing. This may include borrowing in advance of future years' requirements provided that overall borrowing is maintained within the Council's projected CFR and its approved Affordable Borrowing Limit.
  31. The maturity term of new borrowing will be consistent with the Council maintaining a prudent loans maturity profile in accordance with its Prudential Indicators.
  32. **The Option for Forward Funding:** The Council does not have to rely on borrowing in discrete financial years to fund its capital financing requirement and the strategy provides flexibility to take forward borrowing decisions when rates are favourable and the need to borrow can be demonstrated. Overall borrowing must still be within the Council's Affordable Borrowing Limit.
  33. **'Trigger' rates for borrowing:** The Council's treasury advisor, provides economic and interest rate forecasts as well as formulating views on borrowing and lending opportunities.
  34. The Council will maintain a pragmatic approach to borrowing, bearing in mind the Council's debt maturity profile and the need to minimise borrowing costs without compromising longer-term stability of the portfolio. Total borrowing for the year will be reported to Council in July 2010 as part of the Treasury Management Outturn report.

## Value for Money

35. One of the key elements of the TMSS is to ensure the minimisation of borrowing cost and the maximisation of investment income commensurate with the level of risk exposure the Council feels is appropriate. Whilst recent events have underlined the potential pitfalls of exposure to risk for financial gain, this does not mean that Treasury Management activity can ignore value for money principles.
36. The Council has applied its TMSS in making borrowing and investment decisions and has taken a very active stance in restructuring and changing both its borrowing and investment portfolio in response to changing market conditions.
37. In terms of assessing value for money, the Council monitors three key indicators, the details of which are shown in the table below and indicate that the direction of travel for the Council is very favourable. Furthermore comparing the Council's CRI with other authorities has shown that the council has one of the lowest rates in the country.
38. The table below shows our target and actual rates for the key Indicators set for Treasury Management.

	Target 2007/08 %	2007/08 Actual %	Target 2008/09 %	2008/09 Actual %	Target 2009/10 %	Estimate 2009/10 %
Consolidated Rate of Interest		4.91		4.35		1.93
Temporary Borrowing	5.73	5.70	3.93	3.10	0.63	0.45
Average Long Term Borrowing	5.00	4.47	5.00	4.15	5.00	3.18
Temporary Investments	5.70	6.00	3.90	5.16	0.60	0.80

The CRI is shown as actual only, to demonstrate the direction of travel, since it is not practical to set a target for this indicator due to complexities of measuring the overall debt portfolio over time.

### Debt Rescheduling:

39. The Council will continue to maintain a flexible policy for debt rescheduling. Market volatility may provide opportunities for restructuring debt from time to time. The rationale for restructuring 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.
40. The rescheduling of PWLB debt since the introduction of its repayment rates on 1st November 2007 has not ceased, but has become undoubtedly harder and places greater emphasis on the timing and type of new borrowing.
  41. In September 2009, the PWLB issued a Consultation document, entitled 'PWLB Fixed Rates', where the PWLB is reviewing the frequency of rate setting (currently daily) and could move to a live pricing basis. The deadline for the consultation period was 08/01/2010. The likely outcome of this is a reduction in the extent of the margins between premature repayment and new borrowing rates, particularly for longer maturities.
  42. The Council's debt portfolio is monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by the Council's treasury management advisors and discussed with the Council's officers. Any rescheduling activity will be undertaken within the Council's treasury management policy and strategy and will comply with the accounting requirements of the local authority SoRP and regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573).
  43. Borrowing and debt rescheduling activity will be reported as part of quarterly monitoring, as part of outturn and in future updates to this strategy.

#### **Investment Policy and Strategy:**

##### ***Policy***

45. Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix 3.
46. The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Council will continue to maintain a counterparty list based on its criteria and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined in paragraph 54-58.
47. The Council's current level of investments is presented at Appendix 1.

##### ***Investment Strategy***

48. The global financial market storm in 2008 and 2009 has forced investors of public money to reappraise the question of risk versus yield. Income from investments is key in supporting the Council's budget.
49. The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates are likely to remain at very low levels which will have a significant impact on investment income. The Council's strategy must however be geared towards this development whilst adhering to the principal objective of security of invested monies.
50. The Chief Financial Officer, under delegated powers, 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 Council as part of the Treasury Management Outturn report in July 2010.

51. The Council's shorter term cashflow investments are made with reference to the outlook for the UK Bank Rate and money market rates.
52. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office. Currently the Council has restricted its investment activity to:
  - The Debt Management Agency Deposit Facility (DMADF) which is guaranteed by the UK Government and is therefore a AAA rated investment. (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure)
  - AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
  - Deposits with other local authorities
  - Business reserve accounts and Term deposits These have been primarily restricted to UK institutions that are rated at least AA- long term, and have access to the UK Government's 2008 Credit Guarantee Scheme (CGS)
  - Bonds issued by Multilateral Development Banks (*see Appendix 4 for a breakdown of current counterparties, instruments and limits used.*)
53. The following table shows how the Council has increased its investments in higher credit rated institutions (AAA) and reduced it's exposure in lower rated institutions (A) in response to the changing environment.

Credit Rating	Investments 31 March 08	Investments 31 March 09	Investments 31 Dec 09
A	44%	37%	0%
AA	51%	35%	62%
AAA	5%	28%	38%
Total	100%	100%	100%

54. Conditions in the financial sector have begun to show signs of improvement, albeit with substantial intervention by government authorities. In order to diversify the counterparty list, the use of comparable non-UK Banks for investments is now considered appropriate.
55. The sovereign states whose banks are to be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries, and the Banks within them (see Appendix 4), have been selected after analysis and careful monitoring of:
- Credit Ratings (minimum long-term AA-)
  - Credit Default Swaps
  - GDP; Net Debt as a Percentage of GDP
  - Sovereign Support Mechanisms/potential support from a well-resourced parent institution
  - Share Price
56. The Council has also taken into account information on corporate developments and market sentiment towards the counterparties. The Council and its Treasury Advisors, 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.
57. We do remain in a heightened state of sensitivity to risk. Vigilance is key. This modest expansion of the counterparty list is an incremental step. In order to meet requirements of the revised CIPFA Treasury Management Code, the Council is focusing on a range of indicators (as stated above), not just credit ratings.
58. Limits for Specified Investments are set out in Appendix 4.

#### **Balanced Budget Requirement**

59. The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

## 2010/11 MRP Statement

60. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to “have regard” to such Guidance under section 21(1A) of the Local Government Act 2003. The four options available are:  
 Option 1: Regulatory Method  
 Option 2: CFR Method  
 Option 3: Asset Life Method  
 Option 4: Depreciation Method
61. The 2009 SORP and IFRS will result in PFI schemes and certain leases being brought on balance sheet. Where this is the case the CFR will increase, which will lead to an increase in the MRP charge to revenue. MRP for these items will match the annual principal repayment for the associated deferred liability.
62. MRP in 2010/11: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).
63. The MRP Statement has to be submitted to Council before the start of the 2010/11 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Council at that time. The proposed MRP charges for 2010 are detailed below.

	31-Mar-10 Estimate £'000	31-Mar-11 Estimate £'000	31-Mar-12 Estimate £'000	31-Mar-13 Estimate £'000
Supported Borrowing	4,226	3,922	3,901	3,671
Unsupported Borrowing	675	1,479	1,856	1,932
HCC Transferred Debt	799	768	737	707
PFI and Finance Leases	850	901	955	1,012
<b>Total MRP</b>	<b>6,550</b>	<b>7,069</b>	<b>7,448</b>	<b>7,322</b>

64. MRP in respect of PFI and leases brought on Balance Sheet under the 2009 SORP and IFRS will match the annual principal repayment for the associated

deferred liability.

65. The Council adopted Option 1 in respect of capital expenditure financed by supported borrowing and Option 3 in respect of unsupported capital borrowing, but this does not exclude any other prudent methods that might meet the needs of the Council.

### **Report on the Annual Treasury Outturn**

66. The Chief Financial Officer will report to the Audit Committee on treasury management activity / performance as follows:
- (a) Quarterly against the strategy approved for the year.
  - (b) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.

### **Member Training**

67. CIPFA's revised Code requires the responsible officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Training was undertaken on the 10<sup>th</sup> December 2009.

## **FINANCIAL/RESOURCE IMPLICATIONS**

### **Capital**

68. The Capital implications are considered as part of the General Fund Capital Programme report and HRA Capital Programme report elsewhere on the agenda.

### **Revenue**

69. The Revenue implications are considered as part of the General Fund Revenue Budget report and HRA Revenue Budget report elsewhere on the agenda

### **Property**

70. None

### **Other**

71. None

## **LEGAL IMPLICATIONS**

### **Statutory power to undertake proposals in the report:**

72. Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System.
73. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made



in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.

**Other Legal Implications:**

74. None

**POLICY FRAMEWORK IMPLICATIONS**

75. This report has been prepared in accordance with CIPFA’s Code of Practice on Treasury Management

**SUPPORTING DOCUMENTATION**

**Appendices**

1.	Current and Projected Portfolio Position
2.	Prudential Indicators for 2010/11– 2012/13
3.	Economic and Interest Outlook
4.	Specified and Non Specified Investments for use by the Council.

**Documents In Members’ Rooms**

1.	None
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**Background Documents**

Title of Background Paper(s) None	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
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**Background documents available for inspection at:** N/A

**FORWARD PLAN No:** N/A                      **KEY DECISION?** N/A

<b>WARDS/COMMUNITIES AFFECTED:</b>	All
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