

REPORT TO CABINET

Title: **TREASURY MANAGEMENT**
Date: 11 February 2010
Member Reporting: Councillor Kellaway
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Wards affected: All

1. SUMMARY

- 1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) has updated its Treasury Management Code of Practice recognising the impact the recent recession has on the finance of public bodies. The new code requires the Council to demonstrate proper management of its treasury function in line with CIPFA's definition to: "Management of the organisations investments and cash flows, its banking, money market and capital market; the effective control of the risks associated with these activities and the pursuit of optimum performance consistent with those risks". This Council adopted the previous code of practice (2002) and this report recommends that the Council accepts the revisions contained within the 2009 code of practice
- 1.2 In line with the Code of Practice the Council is recommended to accept the Treasury Management Strategy for 2010/11 and the associated Prudential Performance Indicators that will be monitored during the year

2. RECOMMENDATION

- 2.1 **That the Council modifies its Standing Orders related to Treasury Management according to paragraph 3.6 of the report during the current review of the Constitution**
- 2.2 **Adopt the CIPFA's Treasury Management Code of Practice the key elements of which are contained in Annex 1**
- 2.3 **Adopt the Treasury Management policy statement contained within paragraph 4.1 of the report.**
- 2.4 **Accept the Treasury Management Statement shown in Annex 2 which includes an approved list of counter parties in Appendix 5 and proposed prudential indicators in Appendix 6 of the report.**

3. SUPPORTING INFORMATION

Background

3.1 The Council adopted the Treasury Management Code of Practice in 2002 when CIPFA published its code that year to help the public sector ensure that proper governance of its finances. In 2003 the Prudential Code was introduced which ensured consistent application of capital investment funding and finance and introduced the concept of investment with a mind to affordability. Over the last year the finance of local authority's have undergone further pressure as interest rates and confidence in the banking sector declined.

3.2 The new Treasury Management code of practice updates the 2002 guidance and especially considers the impact the collapse of the two Icelandic banks had upon the confidence the public sector has in investing in private banking institutions.

The 2009 Treasury Management Code

3.3 The new code regularises many of the activities contained within the old code but emphasises the importance that the Prudential Code (also updated for 2009) has upon the investment decisions of the Council.

3.4 Copies of the 2009 Treasury Management Code of Practice and Prudential Code are available in the members' room and on the council intranet for deeper review. However, the general thrust of these papers is contained within its key principles:

- The authority should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of its treasury management activities
- The policies and practices should make clear that the effective management and control of risk are prime objectives of the treasury management activities and that responsibility for these lies clearly within the organisation. The appetite for risk should form part of the annual strategy and should ensure that priority is given to security and liquidity when investing funds
- The authority should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management the treasury management policies and practices should reflect this.

3.5 In general local authorities should be more concerned to avoid risk than to maximise returns.

New Treasury Management Standing Orders

3.6 To encompass these principles CIPFA have re-written the standing orders that it recommends the Council adopt. The Council's constitution on Treasury Management is contained within paragraphs C13 to C19. CIPFA recommends replacing these with the following which recognises the key principles

- The Council 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 (TMP's), 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 Council (i.e. Cabinet) 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, mid year review and an annual report after its close, in the form prescribed in its TMP's
- The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Audit and Performance Review panel, and for the execution and administration of treasury management decisions to the Head of Finance, who will act in accordance with the Council's policy statement and TMP's and, if a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management
- The Council nominates the Audit and Performance Review panel to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. Treasury Management Policy Statement

In line with CIPFA's Treasury Management code of practice the Council has adopted the following policy statement:

POLICIES AND OBJECTIVES

4.1 The Council defines its treasury management activities as:

- The management of the Council's investment's and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with these activities; and the pursuit of optimum performance consistent with those identified risks
- The Council regards the successful identification, monitoring and control of risks to be 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 the risk implications for the Council.
- 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 principle of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

For 2010/11 the Head of Finance has developed a number of objectives for 2010/11 which the Council is invited to agree. These are listed included in Annex 2, Appendix 1 of this report

Treasury Management Practices

- 4.2 Supporting the Treasury Management Policy Statement the Council has adopted the treasury management practices (TMPs) included in Annex 1 to this report.

Treasury Management Strategy

- 4.3 In constructing the 2010/11 Budget various Treasury Management assumptions were made and these are contained within the Treasury Management Strategy included in Annex 2 to this report. The strategy also includes various monitoring and performance indicators, required under CIPFA's Prudential code of practice. The head of Finance will monitor the strategy through the year and regularly report the position to the Audit and Performance Review panel. The strategy, in particular includes:

- Interest Rate Projections and Economic Conditions
- Capital Financing Strategy
- Minimum Revenue Provision
- Borrowing Strategy
- Investment Strategy
- Managing Investment Performance
- Prudential Indicators
- Statutory Determination

4.4 Approved Counterparties

- 4.4.1 The Council has kept its list of approved counterparties that it is prepared to make deposits with under regular review over the last 18 months. The Council has, understandably, erred on the side of caution and currently operates with a very "safe" list. There are times when officers are unable to place monies and funds are left on call with Lloyds Bank. This has two effects one is that a significant proportion of the Council's funds are with one institution which, although Lloyds is largely Government owned, is not ideal from a spread of risk point of view. The second is that the Council runs the risk of not achieving the best return on its deposits.
- 4.4.2 The potential solution to this issue is to review the list of Building Societies (traditionally the "home" for Local Authority Deposits) and increase the number on the list. The current list includes only those Building Societies that carry a minimum A Fitch rating. Not all Building Societies apply for a Fitch rating and a review is currently under way to investigate alternative means of assuring the financial well being of these institutions before they are considered for the list of counterparties.
- 4.4.3 A second alternative would be to look at institutions based outside of the UK. The proposal is to deposit funds with financial institutions that are FSA regulated, based in either the US or the EU and that carry a high Fitch credit rating.
- 4.4.4 The banking sector has recently been described by the Bank of England as being much more "stable" and it is perhaps the time to look at our current cautious approach. Recent experience has shown that banks operating from within the EU or US have been able to access Government support if they need to and should be seen as safe homes for limited deposits of Council funds.
- 4.4.5 Enquiries with our Brokers have indicated that a number of institutions would be interested in dealing with the amounts of money that local authorities tend to have available to deal in and this list is appended to the report. Appendix 5 contains a list

of the current approved counterparties together with a list of proposed additional counterparties that meet the criteria outlined in paragraph 4.4.3

5. OPTIONS AVAILABLE AND RISK ASSESSMENT

5.1 Options

	Option	Comments	Financial Implications
1.	Accept the recommendations	Ensures that the Royal Borough adopts best practice and enables monitoring mechanisms to minimise financial risk 5.1 RECOMMENDED	None
2.	Reject the recommendations	This is not an option as the Council has a duty to receive and accept an annual treasury management strategy and performance monitoring indicators under the 2003 Local Government Act	
3.	Modify the recommendations	Whilst the Council must adopt an annual treasury management strategy and performance indicators it could modify their content. However, the proposed items have taken the best current views available and the Head of Finance has included monitoring mechanisms to advise members where the statements require modification during the year.	

5.2 Risk assessment

Adopting the recommendations places the Council at no direct financial risk and the monitoring process will ensure any members are appraised of significant change.

6. CONSULTATIONS CARRIED OUT

The Head of Finance has consulted money markets partners and taken views from the Bank of England and other financial institutions in constructing the strategy content. The strategy and associated supporting papers follow CIPFA recommended best practice.

7. COMMENTS FROM THE OVERVIEW AND SCRUTINY PANEL

The Corporate Services Overview and Scrutiny Panel meets on 01 February 2010 and their views will be reported verbally.

8. IMPLICATIONS

The following implications have been addressed where indicated below.

Financial	Legal	Human Rights Act	Planning	Sustainable Development	Diversity & Equality
✓	✓	N/A	N/A	N/A	N/A

Background Papers: Local Tax Base figures 2010-11.xls; CTB1 report ct6140d

TMP1 RISK MANAGEMENT

General statement

The Head of Finance will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting requirements and management information arrangements. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

1. Credit and counter party risk management

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counter party lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments, methods and techniques* and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counter party policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.

2. Liquidity risk management

The Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

The Council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities

3. Interest rate risk management

The Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 *Reporting requirements and management information arrangements*.

It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. Any decision will be subject to the consideration and, if required, approval of any policy or budgetary implications.

4. Exchange rate risk management

The Council will manage any exposure to fluctuations in exchange rates, when, where and if they occur, so as to minimise any detrimental impact on its budgeted income/ expenditure levels.

5. Refinancing risk management

The Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

6. Legal and regulatory risk management

The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1[1] credit and counterparty risk management, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

7. Fraud, error and corruption, and contingency management

The Council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

8. Market risk management

The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP2 PERFORMANCE MEASUREMENT

The Council is committed to the pursuit of value in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out in the schedule to this document.

TMP3 DECISION-MAKING AND ANALYSIS

The Council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the schedule to this document.

TMP4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

The Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 Risk management.

TMP5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

The Council considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when the Council intends, as a result of lack of resources or other circumstances, to depart from these principles, the Head of Finance will ensure that the reasons are properly reported in accordance with TMP6 *Reporting requirements and management information arrangements*, and the implications properly considered and evaluated.

The Head of Finance will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The Head of Finance will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.

The Head of Finance will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the schedule to this document.

The delegations to the Head of Finance in respect of treasury management are set out in the schedule to this document. The Head of Finance will fulfil all such responsibilities in accordance with the organisation's policy statement and TMPs and, if a CIPFA member, the *Standard of Professional Practice on Treasury Management*.

TMP6 Reporting requirements and management information arrangements

The Council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum:

The Cabinet will receive:

- an annual report on the strategy and plan to be pursued in the coming year
- a mid-year review
- an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation's treasury management policy statement and TMPs.

The Audit and Performance review panel will receive regular monitoring reports on treasury management activities and risks.

The Corporate Overview and Scrutiny panel will have responsibility for the scrutiny of treasury management policies and practices.

The Audit and Performance Review panel will have received regular monitoring reports in respect of activities contained within the CIPFA Prudential Code.

The present arrangements and the form of these reports are detailed in the schedule to this document.

TMP7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

The Head of Finance will prepare, and the Council will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with *TMP1 Risk management*, *TMP2 Performance measurement*, and *TMP4 Approved instruments, methods and techniques*. The Head of Finance will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with *TMP6 Reporting requirements and management information arrangements*.

The Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

TMP8 CASH AND CASH FLOW MANAGEMENT

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the Council will be under the control of the Head of Finance, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Head of Finance will ensure that these are adequate for the purposes of monitoring compliance with *TMP1[1] liquidity risk management*. The present arrangements for preparing cash flow projections, and their form, are set out in the schedule to this document.

TMP9 MONEY LAUNDERING

The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the schedule to this document.

TMP10 TRAINING AND QUALIFICATIONS

The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Head of Finance will recommend and implement the necessary arrangements.

The Head of Finance will ensure that members of the Audit and Performance review and Corporate Overview and Scrutiny panels have access to training relevant to their needs and responsibilities

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively

The present arrangements are detailed in the schedule to this document.

TMP11 USE OF EXTERNAL SERVICE PROVIDERS

The Council recognises that the responsibility for treasury management decisions remains with the Council at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure that it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will also 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. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid overreliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Head of Finance, and details of the current arrangements are set out in the schedule to this document.

TMP12 CORPORATE GOVERNANCE

The Council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

The Council has adopted and has implemented the key principles of the Code. This, together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Head of Finance will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

TREASURY MANAGEMENT STRATEGY 2010/11

Annex 2

1. Introduction

- 1.1 The Council's Treasury Management Strategy for 2010/11 considers the impact of anticipated capital and revenue cash flows, the maintenance of existing loan debt, the availability and use of internal sources of finance such as revenue reserve, capital funds and capital receipts unapplied. Where surplus cash is available the strategy considers the extent to which these should be invested. The strategy considers the need for the Council to consider alternative financing options such as borrowing and reviews the potential trends in interest rates. Integral to the strategy is the setting of the various Indicators required by the Prudential Code (updated in 2009) that the Audit and Performance Review panel will monitor.
- 1.2 The Council has average cash balances of some £35m which are used to fund day to day service operations and support capital funding through the use of internal resources. Any surplus funds are invested within constraints set out by the Secretary of State. The Council also has approximately £57m in outstanding external loan debt which has built up over time to fund its fixed assets. The Head of Finance manages both the day to day cash requirements (including the investment of surplus funds) and the borrowing requirements of the Council through an in-house treasury management team. Cash investment earnings of £0.6m and capital financing costs of £5.5m, together with £1m to fund short term assets, are within the Council's proposed 2010/11 revenue budgets and reflect the financial implications of the proposed capital programme.
- 1.3 The Council's investment and borrowing policies are governed by the Local Government Act 2003 and the Secretary of State's Investment Code. These contain regulations backed up by various Codes of Practice. The CIPFA Treasury Management Code of Practice, which the Council has formally adopted and the Secretary of State's Investment Code, both require the Head of Finance, before the beginning of each financial year, to present an Annual Treasury Management Strategy and an Annual Investment Strategy for the forthcoming year for approval by the full Council. The Council also implemented the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 requiring Council to approve an Annual Statement of Minimum Revenue Provision which is the amount set aside from revenue for the repayment of debt principal relating to the General Fund only.
- 1.4 The CIPFA Prudential Code for Capital Finance in Local Authorities sets out indicators that are used to support capital expenditure plans and treasury management decisions. The Prudential Indicators are set by the Council at budget time and are to be monitored during the year.
- 1.5 Section 3 of the Local Government Act 2003 requires the Council to approve an "affordable borrowing limit". This is the maximum level of loan debt that may be outstanding at any point in time. This is set having regard for the overall treasury management strategy.
- 1.6 Finally, it is a statutory requirement under S33 of the Local Government and Finance Act 1992 for the Council to produce a balanced budget, and in particular this includes the impact of revenue costs flowing from capital expenditure financing decisions. The Head of Finance confirms that the capital expenditure plans comply with the statutory requirement to set a balanced budget.

2. Interest Rate Assumptions

- 2.1 The assumptions on interest rates and their projected movement during the three year planning period represent a key element of the treasury management strategy. These assumptions are based on information gained from a wide range of sources in the investment market compared to Bank of England projections over the period. These are summarised in the following table derived from the Bank of England Inflation report November 2009.

Table 1: Bank Rate Forecasts

	Bank Rate 2010	Bank Rate 2011
January Forecast	0.5%	1.5%
December Forecast	1.5%	3.0%
Average	1.0%	2.25%
Sector Forecast	1.25%	2.25%

(Source: Bank of England Inflation report 11/09)

- 2.2 At the beginning of December 2009, short term investment interest rates ranged from 0.45% to 0.75% for one to 6 month, 1.20% for 1 years and 1.60% for 2 years. This compares with the Public Works Loans Board (PWLb) borrowing rates which ranged from 0.76% for one year, 2.89% for 5 years, 3.80% for 10 years, 4.27% for 25 years and 4.25% for 50 years. The Monetary Policy Committee of the Bank of England retained the 0.5% bank rate for the tenth month. Whilst internationally some interest rates have increased, the majority have remained static.

Table 2: Comparison of Bank Rate over Time

Date	Previous rate (%)	New rate (%)	Change (%)
05 Dec 2009	0.50	0.50	Nil
08 Nov 2009	0.50	0.50	Nil
04 Oct 2009	0.50	0.50	Nil
06 Sep 2009	0.50	0.50	Nil
08 Aug 2009	0.50	0.50	Nil

- 2.3 2010/11, the Head of Finance, based on the advice he has received, expects the Bank of England Rate to start the year at 0.5% and increase to around 1.5% during the course of 2010. Rates are expected to continue to 3.00% by the end of 2011. However, the recent dislocation between LIBOR and the bank rate means that interest rate forecasts should be treated with caution.

2.4 Table 3: Interest Rate Forecast 2010/11

	Average assumed for the year 2010/11	Trends predicted for the year 2010/11	Actual as at 10 December 2009
Bank of England Bank Rate	1.0%	Starting the year at 0.5% and rising to 1.5% by Q4 2010	0.5%
PWLB Rate			
- 5 years	N/A	Increase in rates between 10-15 years with little variations in longer term borrowing	2.89%
- 10 years	3.60% - 3.90%		3.80%
- 15 years	N/A		4.16%
- 25 years	4.10% - 4.25%		4.27%
- 50 years	4.20% - 4.25%		4.25%
Average rate of all loans borrowed by the Council	4.78%		4.78%

- 2.4 The table above shows that under 10 year PWLB rates are expected to be lower than longer term PWLB rates. This provides opportunities for spreading debt maturities away from a concentration in long dated debt especially as interest rates are now at relatively low levels.
- 2.5 In the current economic environment interest rate projections over the short term are volatile, so the above forecasts cannot be relied upon to hold true for the whole of the coming year. The Head of Finance will monitor interest rate projections carefully and adjust financing and investment strategies accordingly

3. Capital Financing Strategy

- 3.1 The current (“Prudential”) System of capital controls, allows the Council to determine its own level of capital investment. However, the Council must demonstrate that its capital programme is affordable, prudent and sustainable. In the short term the proposed capital programme can be financed from within existing internal resources. However, the Council will consider proposals to finance a project from external borrowing where a positive return on investment, within a five year period, is demonstrated. The current economic climate and the downturn in the commercial property market is having a detrimental impact on asset values and Capital receipts over the next three years are expected, therefore, to be at a relatively lower level. Any delays in receiving cash from anticipated receipts will be covered through the temporary use of unsupported short term borrowing.
- 3.2 Although the capital programme is planned with reference to the total level of resources available to finance capital expenditure, the method of financing individual capital schemes will be determined by the Head of Finance at the end of the financial year. The order of use of sources of finance for the capital programme is:
1. Capital Grants
 2. Capital Contributions from outside bodies e.g. Section 106
 3. Capital Receipts
 4. Direct Revenue Contributions – mainly for short life assets
 5. Draw down from accumulated investments (set aside to repay debt)
 6. Prudential Borrowing (unsupported) to finance ‘invest to save’ schemes and pending the arrival of future known capital receipts

In addition,

7. Leasing will also be considered if more cost effective and
8. Whilst PFI financing solutions is an option for large value projects, in the medium term, there are no schemes that fall into this category. However, this method will be considered if the opportunity arises and Cabinet and Council will receive appropriate reports.

- 3.3 Capital Grants and external contributions are likely to have been received for specific schemes and therefore cannot be used for any other purpose. For other schemes, capital receipts are to be used in preference to revenue contributions or borrowing.
- 3.4 Capital Receipts will be fully applied in the year in which they are received to reduce the level of Minimum Revenue Provision (MRP) i.e. the monies that the Council sets aside for debt repayment. Unlike the private sector, local authorities are not required to write down the book value of their capital assets in line with the assets' depreciation. Instead a prescribed formula is used to determine the MRP.

Minimum Revenue Provision (MRP) Policy Statement

- 3.5 Regulations, introduced in 2008, require the Council to approve a Minimum Revenue Provision Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits.
- 3.6 The Head of Finance recommends continuing the policy adopted by the Council during the 2009/10 budget approval process. i.e.

This Council Minimum Revenue Provision policy is to calculate its Minimum Revenue Provision for 2010/11 at 4% of the adjusted capital financing requirement as contained in its Medium Term Financial Plan.

Where the Council approves an "invest to save" scheme, it will fund the cost from prudential borrowing and make a charge to the appropriate revenue account equivalent to a depreciation charge, in accordance with standard depreciation accounting procedures.

Borrowing Strategy

- 3.7 The Council has prepared and published a three-year capital expenditure plan to 2012/13 and will undertake limited short term borrowing to ensure the affordability and delivery of the capital programme.
- 3.8 The capital financing assumes no additional long term borrowing over the next three years, and there are no maturing loans requiring replacement. Low interest rates offer the opportunity to restructure the Council's more expensive debt. However, a large element of the Council's debt was taken out for 50 years and penalties arising from early repayment are, at present, prohibitive. The Head of Finance will however, keep the situation under regular review and report any changes in circumstance that change this situation. The various loan resources available to local authorities are detailed in Appendix 3.

- 3.9** In the current economic climate of low interest rates, entering into new external debt would have the effect of reducing the average rate of interest on the debt portfolio and may offer good value for money in terms of lower debt servicing costs. However, this Council will not enter into further long term borrowing without a business case to support that option.
- 3.10** The Council inherited much of its borrowing maturity following the transfer of ex-Berkshire debt from Reading. The Head of Finance will ensure that future borrowings to limit the proportion of borrowing maturing in any one financial year and in doing so safeguarding against the possibility of borrowing at a time of unfavourable interest rates. The maturity analysis of all borrowing and loans held by the Council is shown in Appendix 4.
- 3.11** The debt portfolio also consists of two Lenders Option Borrowers Options (LOBOs) totalling £13 million. The first option is not due for several years. However, if the current bank rates continue it is unlikely that the lenders would exercise their options for repayment under Lenders Option Borrowers Option given the bank rate, 0.5% (December 2009), is significantly lower than the rate of return paid by the Council on LOBO debt, currently 4.19%. The reasonable assumption is that LOBOs will run to full term.
- 3.12** With regard to PWLB debt, the Head of Finance will ensure the prudent planning of any new loans taken out. The Head of Finance will continue to review the potential to restructure the older and more costly debt and, where it is economic to do so, will recommend implementing debt restructuring strategies where feasible to reduce refinancing risk and increase value for money.
- 3.13** The authorised limit for external borrowing is the highest level of borrowing expected during the year to cover any exceptional adverse cash flow movements when payments run ahead of receipts and/ or any changes in borrowing which could arise to cover capital schemes funded through prudential borrowing. Once agreed it is a ceiling which should not be exceeded without further Council approval. The authorised limit is shown in Appendix 6.
- 3.14** The operational boundary is the maximum borrowing that should be required if there are no exceptional cash flow movements. This is to ensure that in normal circumstances borrowing is only used to finance capital expenditure. The operational boundary is shown in Appendix 6.

Investment Strategy

- 3.15** S12 of the Local Government Act 2003 gives a local authority power to invest for “any purpose relevant to its functions under any enactment or for the prudent management of its financial affairs”. S15(1) of the 2003 Act requires an authority to “have regard to such guidance as the Secretary of State may issue”, and the Secretary of State issued an Investments Code in 2004. The Head of Finance confirms that the strategy set out below complies with these requirements.
- 3.16** Since the collapse of the Icelandic banks and the problems experienced by the banking sector the Head of Finance has kept the counter party lending list under constant review having good regard to the balance between risk and return. The Head of Finance has consulted key Cabinet members in establishing a revised counter party listing which reflects the level of exposure to investment risk the Council is prepared to support and establish a list of banks, building societies and banking institutions which minimise the Council's risk and the limit of exposure using the Fitch credit rating methodology. The investment limit of each counter party and the current exposure is shown in Appendix 5

Managing Treasury Management Performance

- 3.17** The Treasury Management function is provided by the in-house team that manages the Royal County of Berkshire Pension Fund where excellent performance and risk control has been applied for many years. There is no intention to move away from this arrangement at present. However, CIPFA has recently introduced a Treasury Management qualification that will reinforce the knowledge and experience of the existing team and the Head of Finance has made arrangements for key members of the team to complete this qualification.
- 3.18** The Head of Finance has also implemented a Treasury Management system to support the work of the team. This together with improvements to the cash flow monitoring process will help maximise the return on cash investments.

Prudential Indicators

- 3.19** The objectives of the CIPFA Prudential Code for Capital Finance in Local Authorities are to ensure that local authorities' capital investment plans are affordable, prudent and sustainable. In addition, treasury management decisions must reflect good professional practice and support prudence, affordability and sustainability. The Code also has the objectives of being consistent with and supporting local strategic planning, local asset management planning and proper option appraisal. To demonstrate that the objectives are being fulfilled, and to support and record local decision-making Councils are required to set specific Prudential Indicators. These are not designed to be inter-authority comparative performance indicators and each authority sets its own limits or ratios.
- 3.20** The proposed indicators over the three year planning period are detailed in Appendix 6. Indicators A to G represent tests of affordability (i.e. implications for the Council). The indicators H to J demonstrate both prudence and sustainability (i.e. implications for external borrowing).

Statutory Determinations

- 3.21** The Council must "determine and keep under review" how much money it can afford to borrow – the Affordable Borrowing Limit. This is the maximum amount of loan debt that may be outstanding at any point in time, and includes both borrowing for capital purposes and an allowance for temporary revenue borrowing.
- 3.22** It is proposed that the Affordable Borrowing Limit should be set at the maximum estimated borrowing level for each year. These limits are included as Prudential Indicators D and E in Appendix 6.

Monitoring and Reporting

- 3.23** The treasury management activities during the year will be included in monitoring reports to the Cabinet, Corporate Overview and Scrutiny panel and Audit and Performance panel.

Financial Implications

- 3.24** It is a statutory requirement under S33 of the Local Government and Finance Act 1992 for the Council to produce a balanced budget and, in particular, this includes the impact of revenue costs flowing from capital expenditure financing decisions. The Director of Finance confirms that the capital expenditure plans comply with the statutory requirement to set a balanced budget.

3.25 The strategy for treasury management is to maximise, in a prudent fashion, investment income and to minimise interest payments on debt.

Interest Payable on External/Internal Debt

3.26 In 2009/10, interest payments will amount to an estimated £3.1m. The projected out-turn for 2010/11 is also £3.1m. These amounts have been included in the Council's revenue budget.

Interest Receivable on Investments

3.27 The following table sets out interest income budgets in the draft business plans and compares these with likely interest income assuming that future interest rates are as projected above and that the Council's balances continue to be held primarily in cash

	2009/10	2010/11	2011/12
	£m	£m	£m
Interest income per original Medium Term Financial plan	1.0	0.8	0.7
Projected interest income per current Medium Term Financial plan	0.8	0.6	1.2

3.28 It can be seen that, in a falling interest rate environment, there is a risk of a shortfall in interest income compared with the business plans.

TREASURY MANAGEMENT OBJECTIVES FOR 2010/11

1. Borrowing

- To minimise the revenue costs of borrowing.
- To manage the Council's debt maturity profile to ensure a spread of maturities over future years.
- To consider all borrowing instruments when considering funding 'invest to save' projects as they arise
- Borrow from the lowest interest rate when new loans are required which should be less than the equivalent PWLB average rate for the year.
- To repay/reschedule debt at the optimum time to yield the lowest premium (or highest discount) and maximum overall savings.

2. Investment

- To maintain capital security.
- To maximise return on investments whilst minimising the risk on the capital sum.

3. Capital Financing

- To maximise the use of capital grants and consider leasing when appropriate.
- To maximise the use of supported borrowing, if available.
- To use unsupported borrowing to finance revenue-saving schemes – in particular invest to save schemes and also for temporary financing pending the arrival of known future capital receipts.
- To appraise various sources of financing, including leasing and private sector finance and any new financial instruments, and apply to finance new capital expenditure, as they are identified, if financially advantageous.
- In 2010/11 to make an annual Minimum Revenue Provision (MRP) for the repayment of debt based on 4% of the capital financing requirement.

APPENDIX 2

GLOSSARY OF TERMS USED IN THE TREASURY MANAGEMENT STRATEGY REPORT

Affordable Borrowing Limit and Authorised limit for external debt	The maximum amount the Council can borrow for capital and revenue purposes, allowing for unusual events. It reflects a level of borrowing which, while not desired, could be afforded but may not be sustainable in the longer term.
Borrowing for Capital Purposes - Supported - Unsupported	The amount of borrowing to finance capital projects for which the Government will give revenue support through the grant system (the capital financing element of Formula Spending Share (FSS)) Additional borrowing the Council may wish to undertake, but for which there will be no financial contribution through the grant system.
Capital Financing requirement	The authority's underlying need to borrow
Capital receipts - reserved and usable parts	Monies received by a local authority when it sells an asset. The balance may be used to finance new capital expenditure, to meet any liability for a credit arrangement, or to repay the principal of loan debt.
CIPFA Treasury Management Code of Practice	The professional code governing treasury management, which the Council has formally adopted.
Credit arrangements	Forms of credit which do not involve borrowing of money, e.g. leases of land and buildings.
Lenders Option / Borrowers Option Loans (LOBO's)	A form of long-term borrowing where loans run at a fixed rate of interest for a fixed period of time, after which the Lender has the option to ask for repayment or change the interest rate on each interest payment date. If the Lender decides to exercise the option to increase the rate the borrower can then decide whether to accept the new terms or repay the loan.
LIBOR	London Inter-Bank Offer Rate – The deposit rate charged by banks to each other. It is widely used a benchmark for the cost of borrowing. The rate of interest earned on deposits (LIBID) is closely linked to LIBOR and is generally one-sixteenth to one-eighth of a per cent below LIBOR.
Money Market fund	A cash management vehicle for short-term liquidity presented in the form of a fund. The fund actively invests its assets in a diversified portfolio of high-grade short-term, money-market instruments following the underlying principles of security, liquidity, and yield. The overriding guiding principle is the preservation of capital.
Net Revenue Stream (NRS)	The NRS for the General Fund is the "Amount to be met from Government Grant", as shown in the consolidated revenue account.
Minimum revenue provision (MRP)	The amount which must be set aside from revenue each year to cover future repayment of loan debt. From 1 April 2004 MRP for General Fund borrowing is 4%
Operational boundary for external debt	The maximum amount of external debt according to probable events and consistent with the level of external debt projected in the estimates.
Public Works Loan Board (PWLB)	Part of the Government's Debt Management Office, making long-term funds available to local authorities on prescribed terms and conditions. The PWLB is normally the cheapest source of fixed rate long-term borrowing for a local authority, and the Board will also act as a lender of last resort.
Structured deposit / note	The major banks offer structured deposits and notes incorporating (a) a mechanism for ensuring capital protection together with (b) exposure to asset classes offering a higher return than cash. The simplest form of capital protection is provided by the bank investing in a zero coupon bond which matures after (say) 5 years. The bond is issued at a discount of (say) 20%, which allows the bank to use the surplus cash to generate an investment return. Banks have also developed proprietary methodologies (e.g. Constant Proportion Portfolio Insurance) that provide capital protection. In both cases, the

	capital protection is underpinned by the fact that the note or deposit is issued by the bank and therefore carries the guarantee offered by its credit rating.
Short Term	Short term plans and forecasts describe treasury management activities of a day to day nature, up to 6 months of any calendar year. These strategies are concerned with the management of working capital and liquidity.
Medium Term	Medium term treasury management plans cover periods up to the end of next financial year whilst the Medium Term Financial Plan covers the current year plus three years.
Long Term	Long term plans and forecasts describe treasury management and business planning strategies that look at periods in excess of the next three financial years. A Private Finance Initiative projects typically considers 25 -30 years.

LOAN RESOURCES AVAILABLE TO LOCAL AUTHORITIES

Long-term Borrowing

Public Works Loan Board (PWLB)

PWLB loans are available for periods ranging from one to 50 years at fixed or variable rates of interest. It is possible to make premature repayments (subject to payment of a premium or discount), or convert from fixed to variable terms and vice versa. Local authorities can borrow amounts from the Board up to their authorised lending limit as agreed by Members.

Money Market Loans

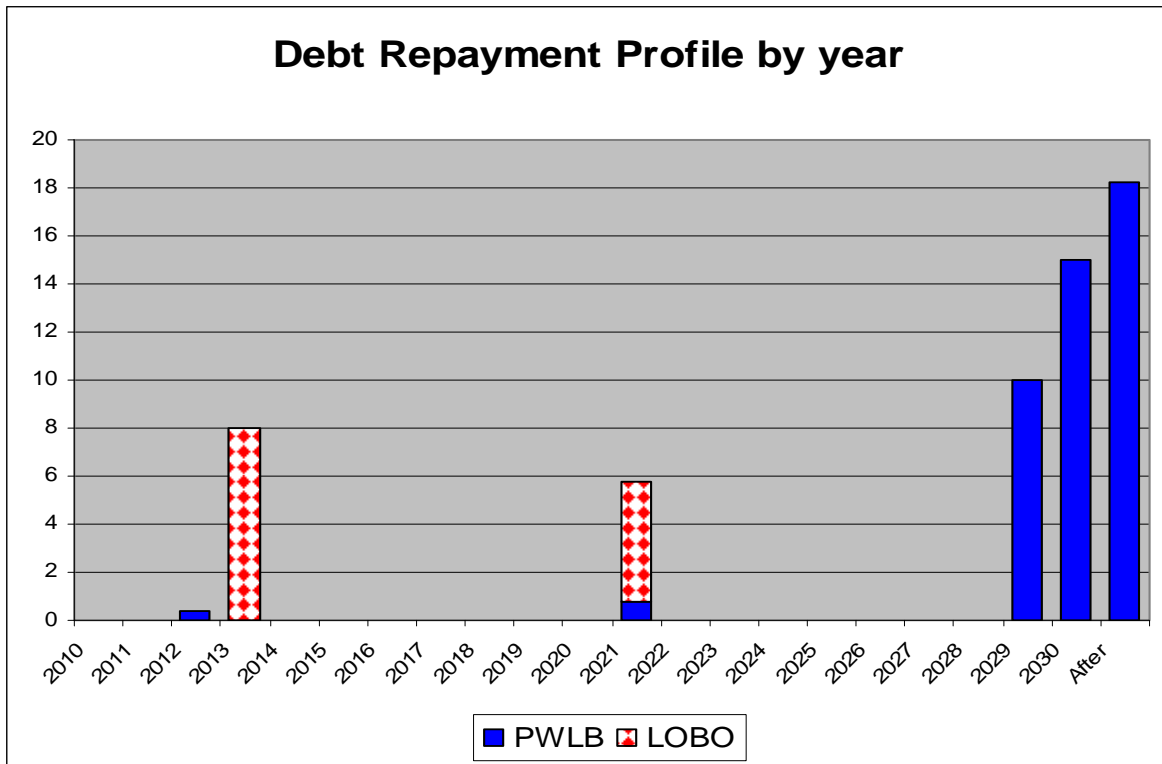
Money can also be borrowed from financial institutions via the money market usually through Lenders Option / Borrowers Option basis (LOBO). These loans run at a fixed rate of interest for a fixed period of time after which, on pre-specified dates, the lender has the option to ask for repayment of the loan or change the interest rate. If the lender decides to exercise the option to increase the rate the borrower can then decide whether to accept the new terms or repay the loan.

Short-term borrowing

The Council will generally have sufficient cash investments to cover short-term day to day bank balance shortfalls. However, if these are insufficient any short term cash shortfall will be met from the lower cost of using the Council overdraft facility with Lloyds TSB (the Council's banker) or by raising a loan from the market. All money market loans will be arranged through the money brokers with whom the Council is in daily contact.

Debt – Rescheduling and Premature Repayments

The Council actively reviews its debt portfolio and where possible will refinance at more beneficial rates as long as the one off redemption costs are not unaffordable.



Note

The amounts shown for LOBO options represent the amounts that would have to be repaid if the lender exercised the option to demand repayment of the loan. Given future interest rates as currently implied by the yield curve the lender would be unlikely to exercise these options.

INVESTMENT CRITERIA

Approved Counterparties for Cash Investments

In response to the recession, the Council has implemented emergency procedures. These procedures limit all new Council investments to the following banks and building societies that have access to the Government rescue package. These institutions have the identified credit rating

The counter parties, limits, credit rating and amount invested at December 2009 are:

UK Banks and Building Societies

<u>Counterparty</u>	FITCH Short Term Rating	FITCH Long Term Rating	Max Sum To Be Lent £m	Max To Be Lent Under CIPFA Guidelines £m	Current Balance Lent to Counterparty £m
<u>UK Government</u>					
Debt Mngt Office	F1+	AAA	15	6	0
<u>Banks</u>					
Abbey	F1+	AA-	15	6	0
Barclays	F1+	AA-	15	6	0
HSBC	F1+	AA	15	6	0
Lloyds	F1+	AA-	15	6	6
Royal Bank Scot.	F1+	AA-	15	6	5
Standard Chart.	F1	A+	15	6	0
<u>Building Societies</u>					
Coventry	F1	A	5	5	0
Leeds	F1	A	5	5	5
Nationwide	F1+	AA-	15	6	6
Norwich & P'boro.	F2	A-	5	5	3
Skipton	F2	A-	5	5	2
Yorkshire	F2	A-	5	5	2
<u>Local Authorities</u>			5	5	5
All UK local authorities excluding those with reported financial irregularities					

FSA Regulated, EU or US based Institutions

<u>Counterparty</u>	FITCH Short Term Rating	FITCH Long Term Rating	Max Sum To Be Lent £m	Max To Be Lent Under CIPFA Guidelines £m
Australia & New Zealand Banking Group	F1+	AA-	15	6
Bayerische Landesbank	F1+	A+	15	6
Calyon	F1+	AA-	15	6
Clydesdale (a subsidiary of Natl Australia Bank)	F1+	AA-	15	6
Commonwealth Bank of Australia	F1+	AA+	15	6
Development Bank of Singapore	F1+	AA-	15	6
Dexia	F1+	A+	15	6
National Australia Bank	F1+	AA	15	6
National Bank of Canada	F1+	A+	15	6
Rabobank	F1+	AA+	15	6
Santander	F1+	AA-	15	6
Unicredito	F1	A	15	6
Wachovia Bank	F1+	AA-	15	6
Wells Fargo	F1+	AA-	15	6

FITCH Ratings Terminology

Short Term Rating - Expectation of timely repayment. F1+ is most likely to repay on time; F1 Highest credit; F2 Good; F3 Fair; B Speculative; C High default risk.

Long Term Rating- Expectation of credit risk. AAA is least likely; AA Very high credit; A High credit; BBB Good; Below BBB indicates non investment grade.

The Head of Finance will continue to review this list and agree changes with the Corporate Overview and Scrutiny Panel.

THE PROPOSED PRUDENTIAL INDICATORS

The objectives of the CIPFA Prudential Code for Capital Finance in Local Authorities are to ensure that local authorities' capital investment plans are affordable, prudent and sustainable. In addition, treasury management decisions must reflect good professional practice and support prudence, affordability and sustainability. The Code also has the objectives of being consistent with and supporting local strategic planning, local asset management planning and proper option appraisal. To demonstrate that the objectives are being fulfilled, and to support and record local decision-making Councils are required to set specific Prudential Indicators. These are not designed to be inter-authority comparative performance indicators and each authority sets its own limits or ratios. It should be noted that where indicators for three years are required, these are rolling scenarios, not fixed for three years. Any indicator can be reviewed at any time, following due process, and must be reviewed when the prudential indicators are set in subsequent years.

A. Capital expenditure

The actual capital expenditure that was incurred in 2008/09 and the estimates of capital expenditure to be incurred for the current year and future years are:

	31/3/09 actual	31/3/10 probable	31/3/11 estimate	31/3/12 estimate	31/3/13 estimate
General Fund	£21.5m	£54.6m	£37.2m	£18.2m	£6.1m

AFFORDABILITY

B. Ratio of financing costs to revenue stream

The actual ratio of financing costs for 2008/09 and estimates of financing cost to net revenue stream for the current and future years are:

	2008/9 actual	2009/10 estimate	2010/11 estimate	2011/12 estimate	2012/13 estimate
Ratio of Financing Costs to net revenue stream					
<i>Non-loan financed</i>	24.0%	48.8%	36.6%	14.0%	6.6%
<i>Loan financed</i>	4.9%	5.4%	5.9%	5.7%	5.9%

* Source: Budget and Council Tax Report 2010/11

C. Capital Financing Requirement

Estimates of the end of year capital financing requirement for current and future years and the actual capital financing requirement as at 31 March 2009.

	31/3/09 actual	31/3/10 probable	31/3/11 estimate	31/3/12 estimate	31/3/13 estimate
General Fund	55.3	58.5	60.1	63.1	67.7

D. Authorised limit for external debt

This is the limit above which external debt must not go without Council approval. The limit reflects the maximum level of borrowing which, whilst not desirable, could be afforded but may not be sustainable. It allows for variations in cash flow and the potential use of borrowing to finance schemes funded through prudential borrowing.

	31/3/09 actual	31/3/10 probable	31/3/11 estimate	31/3/12 estimate	31/3/13 estimate
Borrowing	£58m	£75m	£77m	£80m	£83m

E. Operational boundary for external debt

This is the limit against which external debt will be constantly monitored. It includes both borrowing and long-term liabilities (leases) and encompasses all borrowing whether revenue or capital.

	31/3/09 actual	31/3/10 probable	31/3/11 estimate	31/3/12 estimate	31/3/13 estimate
Borrowing	£58m	£60m	£62m	£65m	£68m

F. Estimate of the incremental impact on Council Tax of capital investment decisions proposed in the Capital Programme report, over and above capital investment decisions taken in previous years

	2010/11 estimate	2011/12 estimate	2012/13 estimate
For Band D Council Tax	£9.73	£12.74	£10.29

The impact of the Capital Programme on the Council Tax has been fully reflected in the Council's Business Plan.

G. Upper limit on fixed interest rate exposures and variable rate exposures

(Note: These are the highest anticipated levels of borrowing and investments, and allow for flexibility between fixed and variable rate exposures). Past borrowing and investment decisions and the current economic climate result in no variable rate investments and borrowing.

	2010/11 estimate	2011/12 estimate	2012/13 estimate
<u>Borrowing</u>			
Fixed interest rate exposures	100%	100%	100%
Variable interest rate exposures	0%	0%	0%
<u>Investments</u>			
Fixed interest rate exposures	70%-90%	70%-90%	70%-90%
Variable interest rate exposures	10%-30%	10%-30%	10%-30%

H. Maturity structure

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate:

	%
Under 12 months	0.0
1 - 2 years	0.0
2 - 5 years	0.0
5 -10 years	0.8
10 - 15 years	1.8
15 - 20 years	16.9
20 - 25 years	50.6
Over 25 years	29.9

This structure allows headroom for temporary borrowing pending receipt of revenues, rescheduling existing debt, and allows for new borrowing with a range of maturity dates, and the possibility that LOBO loans may be called for repayment.

The debt maturity profile at 31 January 2010 is shown in Appendix 4.

I. Limit on Investments for periods over 364 days

	2009/10	2010/11	2011/12
Total principal sums invested for more than 364 days	£10m	£10m	£10m

This limit allows for the implementation of the new investment strategy for the longer term investments

J. The Council has adopted the CIPFA Code of Practice for Treasury Management in Public Services

Yes – as contained within the Council approved constitution.