

CITY OF PLYMOUTH

Subject: Treasury Management Strategy Statement and Annual Investment Strategy 2011/12

Committee: Audit Committee

Date: 21 January 2011

Cabinet Member: Councillor Bowyer

CMT Member: Director for Corporate Support

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Ref: Acct/SW

Key Decision: Yes

Part: I

Executive Summary:

The Local Government Act 2003 requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. Officers have worked closely with the Council's Treasury Management advisors, Arlingclose Ltd, to review the options available to produce a borrowing and investment strategy that seeks to balance financial returns from the Council's cash balances whilst at the same time minimising financial risk to the Council.

This report outlines how the treasury management function contributes to the Council's overall policy objectives. It also outlines the risks inherent within the treasury management function and how officers will seek to minimise those risks.

The borrowing and investment policies proposed in this report therefore offer flexibility for the Director for Corporate Support, acting under delegated powers in accordance with the Constitution, to respond quickly to market circumstances without the need to seek prior Cabinet approval. Any amendments to the Treasury Management Strategy, and the Counter party list, will of course continue to be reported to Cabinet as part of the performance and finance monitoring reports. Changes to the Prudential Indicators can only be approved by Full Council.

The strategy over the medium term will be to align borrowing with the Capital Financing Requirement and Investments with available balances and reserves. Based on the latest capital programme and settlement announcements, no new long term borrowing is anticipated for 2011/12 although this will continue to be kept under review.

The Council will continue to regard Security and Liquidity as the key factors in all its investments with the interest rate achieved only considered after these prime objectives. Following discussions with Arlingclose it is proposed that investments be extended to up to 2 years with organisations meeting the appropriate credit quality. Further details are outlined in the report.

This report also outlines the Council's Prudential Indicators for the next three years as required by the Local Government Act 2003, together with the MRP policy for 2011/12 required under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008. These require approval by Full Council. The CIPFA Code of Practice on Treasury Management requires a formal mid year report and an end of year report, as a minimum, to be produced and presented to Full Council.

Corporate Plan 2010-2013 as amended by the four new priorities for the City and Council:

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Treasury Management affects the Council's budget in terms of borrowing costs and investment returns.

Other Implications: e.g. Section 17 Community Safety, Health and Safety, Risk Management, Equalities Impact Assessment, etc.

The volatility and uncertainty within the global financial markets continues to have a substantial effect on Treasury Management activities. The Council's investment strategy is constantly monitored and acted upon through the Treasury Management Board which meets weekly. The report outlines the risks specific to the treasury management function.

Recommendations & Reasons for recommended action:

1. To approve the Treasury Management Strategy Statement for 2011/12.
2. To approve the Investment Strategy for 2011/12 as outlined in Section 11 of the report.
3. To approve the Lending Organisations and Counter party Limits as outlined in Appendix D

4. To request the Director for Corporate Support, acting under delegated authority in accordance with the Constitution, to keep the lending list under review and update the list during the year as dictated by market circumstances.
5. To recommend to full Council, subject to update following any revision to the capital programme
 - (a) The Prudential Indicators set out in the report
 - (b) The Authorised Borrowing limits of £379m, £376m and £373m for the period 2011/12 to 2013/14
 - (c) The Operational Boundary of £355m, £347m and £334m for 2011/12 to 2013/14
 - (d) The MRP Policy for 2011/12

Alternative options considered and reasons for recommended action:

It is Statutory requirement under the Local Government Act 2003 and supporting Regulations to set a an annual Treasury Strategy for borrowing and prepare an Annual Investment Strategy. Prudential indicators and the MRP policy must be approved by Full Council.

Background papers:

Treasury Management budget working papers

Sign off:

Fin		Leg		HR		Corp Prop		IT		Strat Proc	
Originating SMT Member											

Treasury Management Strategy Statement and Annual Investment Strategy 2011/12

1. Introduction

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in Public Services (the “CIPFA TM Code”) requires local authorities to set a Treasury Management Strategy Statement (TMSS) for borrowing each financial year. The Council is also required to set an Annual Investment Strategy (AIS).

1.2 CIPFA has defined Treasury Management as:

“the management of the organisation’s investments, 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.”

1.3 The Council’s Treasury Management Policy Statement is set out in Appendix A. Treasury Management activity is a key driver for the Council in achieving its objectives. The strategy takes into account the impact of the Council’s revenue budget and capital programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators and the outlook for interest rates.

1.4 Each year, Officers work with the Council’s Treasury Management advisors, currently Arlingclose, to develop a strategy that seeks to balance financial returns from the Council’s cash balances whilst at the same time minimising, as far as possible, the risks associated with treasury management activity. The Council’s detailed Treasury Management Strategy and Annual Investment Strategy is presented to Audit Committee for scrutiny, prior to submission to Full Council for final approval.

1.5 The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy for 2011/12 (Borrowing and Debt Rescheduling - Section 8/9, Investments - Section 10/11)
- Prudential Indicators
- MRP Statement – Section 14
- Use of Specified and Non-Specified Investments – Appendix C
- The Counter party list applicable from 1 April 2011– Appendix D

2. The Council’s Objectives

2.1 The Corporate Plan outlines the Council’s objectives over the medium term period and these are summarised in figure 1 below:

Figure 1

Plymouth 2020 priority descriptors			
Deliver growth	Raise aspiration	Reduce inequality	Provide value for communities
Develop Plymouth as a thriving growth centre by creating the conditions for investment in quality homes, jobs and infrastructure	Promote Plymouth and encourage people to aim higher and take pride in the city	Reduce the inequality gap, particularly in health, between communities	Work together to maximise resources to benefit customers and make internal efficiencies

2.2 The treasury management strategy underpins the achievement of the Council's priorities.

3. Treasury Management Code of Practice and Prudential Code

3.1 Local Authorities have wide powers to borrow and invest but regulation, custom, convention and market practice mean in reality authorities can make only limited use of those powers. In carrying out their day to day treasury management activities, local authorities must have regard to two CIPFA Codes of Practice:

- The Code for Treasury Management in the Public Services
- The Prudential Code

3.2 The Codes require authorities to treat effective risk management as a higher priority than the pursuit of performance, listing priorities as:

Security.. ..Liquidity....Yield

and require evidence of affordability, prudence and sustainability, as measured by the Prudential Indicators

3.3 The Codes outline the principles that should be followed by local authorities for borrowing and investments. The Treasury Management Code in particular concentrates on Investments whilst the Prudential Code covers borrowing strategies.

3.4 The main recommendations within the Codes are:

- All Local Authorities should have an Audit Committee with specific responsibility for the scrutiny of the treasury management function
- Audit Committee members should take their responsibility for that scrutiny seriously and need to ensure they are properly trained.
- Investment priorities should be Security and Liquidity before considering Yield.
- Strategies must be taken to Full Council before the start of the financial year but Councils should consider revised strategies during the year where appropriate.
- Investment Strategies should be formally published.

- Authorities should not just rely on credit ratings but on a wide range of information, including the internet, when determining suitable investment Counter parties.
- Authorities should comment on the use of Consultants and the limits on their liability within their strategies.
- Authorities should comment on investment of borrowing in advance and the risks associated with this.

3.5 The investment and borrowing strategies for 2011/12 as outlined within this report take into account the above recommendations.

4. Impact of the CSR 10 on Treasury Management activity

4.1 The Comprehensive Spending Review (CSR) as announced on 22 October 2010 outlined the following changes that will impact on treasury management activity.

4.2 Changes to PWLB rates

Following the Chancellor's announcement on the Spending Review on 20 October 2010, HM Treasury instructed PWLB to:

- Increase the average borrowing rate on all new loans to an average of 1% above UK Government Gilts to take effect immediately.
- Publish at the end of the month a list of loans it has made to local authorities including the type, amount, term and rate applying to each loan.

The impact of this change was to add approximately 0.9% to rates across the whole range of type and maturity of PWLB new loans. However premature repayment rates will not benefit from the corresponding increase and the PWLB's methodology remains unchanged.

This will increase the cost of any future PWLB borrowing and any rescheduling of a PWLB loan into another PWLB. However there are alternative sources of borrowing and whilst short-term loans are on offer at very low rates this alternative will be pursued. Officers in consultation with our advisers Arlingclose will review all alternative options available to minimise the cost of any future borrowing requirement.

The Government recognises that local authority decisions on borrowing can commit electors to repaying loans for up to 50 years. To ensure that borrowing decisions are transparent and consistent with measures adopted elsewhere in the public sector, HM Treasury has determined that a detailed monthly list of individual local authority loans sourced from PWLB will be published on the PWLB website.

4.3 Tax Increment Finance Powers

The Local Growth White Paper issued on 28 October outlined a number of proposals that would fundamentally change investment in sustainable growth and economic redevelopment. In order to support such activity, the Government outlined proposals to introduce new borrowing powers to enable authorities to carry out Tax Increment Financing (TIF).

TIF would allow Councils to fund key projects by borrowing against future increases in locally collected business rates, although initially TIF would be introduced through a bid based process. However the costs and risk of this borrowing would need to be managed alongside wider borrowing under the Prudential Code. The TIF proposal is to be considered as part of a wider Local Government Resource Review, due to commence early in the new year.

5. **Treasury Management Risk**

5.1 No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of the Council's treasury management activities. The CIPFA code lists risks to treasury activity as:

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

5.2 The Council will continue to minimise risks contained within its current debt and investment portfolios by establishing an integrated debt management and investment policy which balances certainty and security, with liquidity and yield. The Council will continue to make use of short term variable rate borrowing, whilst at the same time seeking to balance its investments across a range of investment instruments. Further details of specific risks in the current borrowing and investment portfolios are outlined in the relevant sections.

5.3 Risk is managed by way of the limits set within the Prudential and Treasury Indicators which are required to be approved by Full Council before the start of each Financial year.

5.4 In addition Arlingclose have developed the following matrix to score the credit risk of an authority's investment portfolio:

- Value weighted average credit risk score
- Value weighted average credit rating score
- Time weighted average credit risk score
- Time weighted average credit risk score

Scoring methodology:

- Value weighted average reflects the credit quality of investments according to the size of the deposit
- Time weighted average reflects the credit quality of investments according to the maturity of the deposit
- Credit quality is calculated as:
 - AAA = highest credit quality = 1
 - D = lowest credit quality = 15

5.5 Council's should aim for A+ or higher credit rating, with a score of 5 or lower, to reflect an investment approach with its main focus on security.

6. The Council's Forecast Treasury Position

6.1 The estimated treasury position for 31/3/2011 and 31/3/2012 is as follows:

Table 1

	31/3/2011 Estimate £m	Ave %	31/3/2012 Estimate £m
External Borrowing			
Fixed Rate PWLB	62.555	5.37	62.555
Fixed Rate – Lobo	81.000	4.42	74.000
Variable Rate – Lobo	49.000	4.43	56.000
Temporary Borrowing ^(see 6.3)	69.000	0.50	82.000
Sub Total External Borrowing	261.555	3.61	274.555
PFI	31.753	8.73	31.017
Finance Leases (2010/11 onwards)	*		*
Total External Debt	293.308		305.572
Total Investments	130.000	1.76	130.000

*Finance lease payments are classified as 'borrowing' and are required to be taken into account in the external debt calculations. The requirement to report on International Financial Reporting Standards (IFRS) basis from 1/4/10 may result in the reclassification of some operating leases to a finance lease. The restatement and reclassification work is still ongoing, although based on work to date it is not anticipated that there will be a significant impact. CLG have implemented mitigating actions in order to ensure the move to IFRS, and the reclassification of leases in particular, does not impact on Council Tax levels.

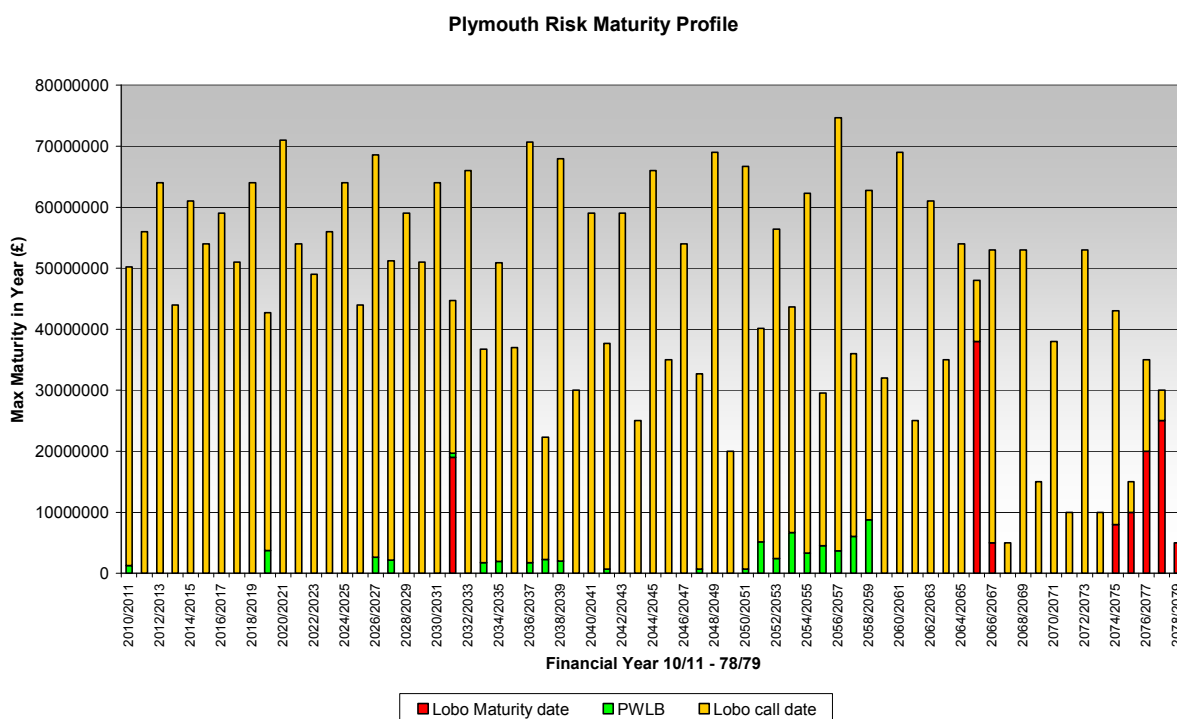
6.2 Lobo loans are lender option borrowing option loans where the lender has the option to vary the rate at pre-agreed dates and the borrower then has the option to accept this rate or repay the loan. The option dates are set for periods ranging from 2 to 5 years. Where the period to the option date is one year or greater the loan is treated as a fixed rate. Where the period to the option date falls below one year the loan then becomes potentially subject to a change in rate in that year and therefore the loan is treated as a variable rate loan.

6.3 The Portfolio above continues to include an element of temporary borrowing. Temporary borrowing is taken in advance to meet future cashflow requirements, and invested in reserve accounts until required. The estimates above assume that short-term market rates will continue to remain below rates available from variable deposits making this strategy advantageous for the Council. However, if borrowing rates rise above those available in liquid deposits the Council will use internal balances to meet cash flow requirements thus reducing the estimated borrowing and investment position by up to £69m at 31/3/2011 and £82m at 31/3/2012. It is not anticipated that any new long term borrowing will be required in 2011/12 and the Council's underlying borrowing strategy remains to reduce long term borrowing.

6.4 Debt Maturity

The following graph shows the maturity profile of the Council's external debt.

Figure 2



The debt portfolio continues to include £130m of LOBO (market) loans. These loans have various option call dates where the banks have the ability to amend the loan terms and at which point the Council could choose to repay the loan if the terms are changed adversely. This is reflected within the maturity profile shown above (in amber) to enable officers to risk manage the Council's cashflows.

6.5 The debt portfolio continues to have a higher weighting of market (LOBO) loans to PWLB. LOBO loans inherently carry a higher risk than PWLB loans as the Council cannot effectively control the repayment of such loans, and is unable to take advantage of rescheduling opportunities when interest rates change. This will be addressed over time with any new long term borrowing taken in PWLB loans.

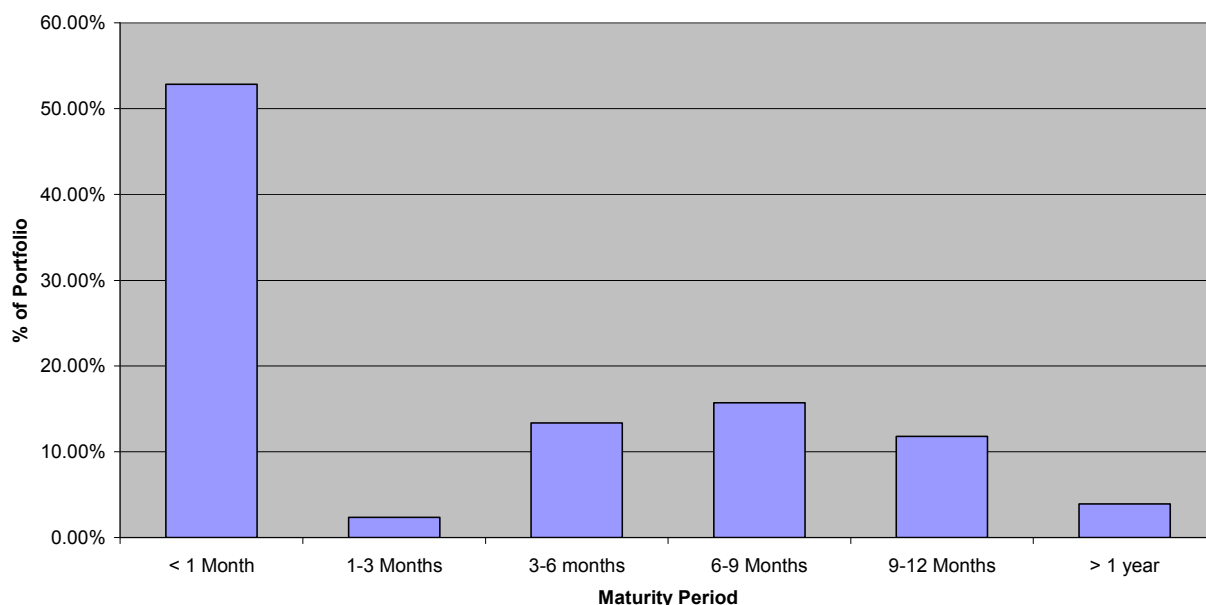
6.6 The estimate for interest payable during 2011/12, as included in the revenue budget, is £9.063m.

6.7 Investments

The Council's investments at 7 January are £171.8m and are estimated to be £293.3m at the end of the year, reflecting the policy of taking temporary borrowing at low rates in advance of forecast cashflow requirements. The actual position at the year end will depend on the availability of relatively low cost finance balanced with the actual payments required to be made by the Council. The graph below shows the current maturity profile of the Council's investments.

Figure 3

Plymouth City Council Investment Maturity Profile 31st December 2010



6.8 The Council's investments at 7 January 2011 were as follows:

Table 2

Counter party	Total £m
Iceland	11.638
Banco Santander	
Santander UK (was Abbey National)	27.825
National Australia Bank	
Clydesdale Bank	29.350
Lloyds Banking Group	
Bank of Scotland	30.000
Barclays	30.000
Royal Bank of Scotland (RBS)	
RBS	25.000
Ulster Bank	5.000
Nationwide	13.000
Total	171.813

6.9 In terms of risk management, with the exception of the £11.6m still held in Iceland, the majority of the investment portfolio is now held either in UK banks or building societies, or UK subsidiaries of foreign banks. Whilst these institutions continue to have access to the Government Credit Guarantee Scheme, there is a risk, albeit a small risk, should the UK Government, ie our sovereign state, collapse.

6.10 Using the Arlingclose risk matrix as outlined in section 5, the Council's current credit risk scoring is as follows:

- Value weighted average credit risk score: 4.22
- Value weighted average credit rating score: AA-
- Time weighted average credit risk score: 4.59
- Time weighted average credit risk score: A+

These remain within the recommended limits. The Investment portfolio will continue to be scored against the matrix during the year to reflect new and maturing investments.

6.11 The estimate for interest receipts for 2011/12 as included in the revenue budget proposals is £0.839m.

7. Outlook for Interest Rates

7.1 The forecast movement in the Official Bank Rate as provided by the Council's treasury advisor, Arlingclose Ltd, is set out below. A more detailed analysis is given in Appendix B.

Table 3

Official Bank Rate

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Upside Risk		+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75
Downside Risk				-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

8. The Council's Borrowing Requirement and Prudential Indicators

8.1 The underlying need to borrow for capital purposes is measured by reference to the Capital Financing Requirement (CFR). 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. The estimated MRP included in the 2011/12 budget is £7.285m.

8.2 Table 4 below shows the estimated CFR over the medium term.

Table 4 Prudential Indicator- CFR

Capital Financing Requirement	31/3/2011 Approved £m	31/3/2011 Revised £m	31/3/2012 Estimate £m	31/3/2013 Estimate £m	31/3/2014 Estimate £m
Total CFR	265.704	264.690	277.112	274.091	271.004

8.3 Capital expenditure not financed from internal resources, ie not from capital receipts, capital grants and contributions, revenue or reserves, will produce an increase in the CFR (the underlying need to borrow) and may in turn produce an increased requirement to charge MRP in the Revenue Account.

8.4 The capital programme is currently under review following the Local Government Finance Settlement announcement. However, supported borrowing previously included within the settlement for capital programmes has been removed and future support will be in the form of capital grants. The Council is currently working through the implications of the settlement and the Prudential Indicators in this report may need to be updated for Full Council. The Council will still be able to undertake unsupported borrowing, although this will be limited given the pressures on the revenue budgets. The estimated borrowing requirement forecast to cover the capital programme over the next 3 based on the current approved programme is:

	£m
2011/12	20.444
2012/13	6.056
2013/14	5.124

An additional £20m of short-term borrowing may be required in 2011/12 to cover the timing differences in realising capital receipts. This borrowing will be repaid from expected capital receipts over the following 3 years. The borrowing requirement is expected to be met from short-term borrowing, cashflow and internal balances.

8.5 Actual 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 estimated of any additional CFR for the current and next two financial years. The Council will have no borrowing in advance at 1 April 2011.

8.6 Under Section 3 of the Local Government Act 2003 and supporting regulations the Council must determine and keep under review how much it can afford to borrow. The Council is required to set two limits:

- The Authorised Limit
- The Operational Boundary

- 8.7 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments). The limits include any PFI or Finance lease repayments. The limits proposed for the medium period are shown in table 5.

Table 5 Prudential Indicator – Authorised Limit for External Debt

Authorised Limit for External Debt	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Borrowing	312	324	347	345	343
Other Long-term Liabilities*	35	32	32	31	30
Total	347	356	379	376	373

*subject to amendment as a result of IFRS finance lease classification

- 8.8 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario, but without the additional headroom included within the Authorised Limit. Table 6 shows the Operational limits proposed for the medium term period.

Table 6 Prudential Indicator – Operational Boundary for External Debt

Operational Boundary for External Debt	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Borrowing	260	293	324	317	304
Other Long-term Liabilities*	35	32	31	30	30
Total	295	325	355	347	334

*subject to amendment as a result of IFRS finance lease classification

- 8.9 The Borrowing limits are required to be formally approved by Full Council, and whilst these can be amended during the year, any amendment also requires full Council approval. The limits will reduce in 2012/13 and 2013/14 as debt is repaid and the forecast borrowing for the capital programme is reduced.
- 8.10 The Director for Corporate Support has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Full Council.
- 8.11 The Prudential Code requires that capital expenditure remains within sustainable limits and, in particular, requires authorities to consider the impact on Council Tax. The tables below show the anticipated capital expenditure over the period to 2013/14 as outlined in the latest approved capital programme and how this expenditure will be financed. These figures remain subject to review in the light of the CSR/settlement.

Table 7 Prudential Indicator – Estimates for Capital Expenditure

Capital Expenditure	2010/11 Approved £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Total	92.179	59.899	22.655	7.030

The capital expenditure is expected to be financed as follows:

Table 8

Capital Financing	2010/11 Approved £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Capital Receipts	7.443	19.572	768	0.500
Grants and Contributions	54.906	17.477	13.231	1.406
Section 106	-	2.391	2.600	-
Revenue contributions	4.949	0.015	-	-
Total Financing	67.298	39.455	16.599	1.906
Borrowing:				
Supported Borrowing	8.166	7.425	7.317	5.124
Unsupported Borrowing	16.715	13.019	(1.261)	-
Total Borrowing Requirement	24.881	20.444	6.056	5.124
Total Financing	92.179	59.899	22.655	7.030

8.12 Incremental Impact of Capital Investment Decisions

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

Table 9 Prudential Indicator – Incremental Impact of Investment Decisions

Incremental Impact of Capital Investment Decisions	2010/11 Approved £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £
Increase in Band D Council Tax	-2.49	2.42	23.08	34.13

- 8.13 The negative impact on Council Tax in 2010/11 is due to the cost of financing the capital programme from short-term borrowing and internal balances being less than the grant received to fund this cost. The impact on the Council tax in 2011/12 and future years reflect the cumulative cost of financing the approved capital programme over the medium term.

8.14 Ratio of Financing Costs to Net Revenue Stream

The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on the costs net of investment income.

Table 10 Prudential Indicator – Ratio of Financing Costs to Net Revenue Stream

Ratio of Financing Costs to Net Revenue Stream	2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
General Fund	6.12	6.12	7.30	8.24	7.88
Devon Debt	1.71	0.36	-	-	-
Total	7.83	8.08	7.30	8.24	7.88

9. **The Borrowing Strategy for 2011/12**

9.1 Borrowing options available to the Council are:

- PWLB loans
- Borrowing from other local authorities
- Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
- Borrowing from the Money Markets
- Local authority stock issues
- Structured finance

9.2 Notwithstanding the issuance of Circular 147 on 20 October following the CSR announcement which increases the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing, the PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing
- Medium-term year Equal Instalments of Principal (EIP) or Annuity Loans
- Long-term Maturity loans, where affordable

9.3 Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term and maintaining stability. The differential between debt costs and investment earnings, despite long term borrowing rates being at low levels, remains significant and this is expected to remain a feature during 2011/12. The "cost of carry" associated with medium- and long-term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short-term costs.

- 9.4 The council's strategy remains to reduce the underlying level of its long term debt. The borrowing strategy for 2011/12 will therefore be to continue to meet the capital financing requirement from short-term fixed rate borrowing or variable rate borrowing where rates are lower than those available to the Council on it's investments. Where borrowing rates are higher than investment rates internal resources will be used in lieu of borrowing with borrowing only taken to cover short-term cash flow requirements. 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.
- 9.5 PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long-term rates and variable rates narrows by 0.50%, this will trigger a formal review point and options will be considered in conjunction with the Authority's Treasury Advisor and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.
- 9.6 The Council has £130m loans which are LOBO loans (Lender's Options Borrower's Option) of which £56m of loans are currently in or will be in their call period in 2011/12. 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/short-term borrowing for repayment or may consider replacing the loan(s) by borrowing from the PWLB.
- 9.7 The Council has no plans to borrow in advance of need and net borrowing will be in line with the Capital Financing Requirement for 2011/12.
- 9.8 The Council may consider debt rescheduling for one or more of the following:
- To achieve savings in interest costs with minimal risk
 - To balance the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
 - To amending the profile of maturing debt to reduce any inherent refinancing risks.

As opportunities arise, they will be discussed with the Council's Treasury Advisors.

- 9.9 Borrowing and rescheduling activity will be reported to the Cabinet in the quarterly monitoring report and a formal treasury management mid year report will be presented to Audit Committee and Full Council.
- 9.10 The following Treasury Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

Table 11 Treasury Indicator – Upper Limits for Interest Rate Exposure

	2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
Upper Limit for Fixed Interest Rate Exposure	200	200	200	200	200
Upper Limit for Variable Interest Rate Exposure	85	85	85	85	85

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

Table 12 Treasury Indicator – Maturity Structure of Fixed Rate Borrowing

Maturity structure of fixed rate borrowing	Approved Upper limit for 2010/11 %	Upper Limit for 2011/12 %	Lower Limit for 2011/12 %
under 12 months	65	50	0
12 months and within 24 months	65	70	0
24 months and within 5 years	55	35	0
5 years and within 10 years	50	25	0
10 years and within 20 years	45	25	0
20 years and within 30 years	45	25	0
30 years and within 40 years	45	25	0
40 years and within 50 years	55	35	0
50 years and above	50	50	0

These limits are based on the risk of Lobo loans being called and repaid at the next option date and not at the final maturity date.

10. Investment Policy

- 10.1 Guidance from CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

- 10.2 The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

- 10.3 The speculative procedure of borrowing purely in order to invest is unlawful and this Council will not engage in such activity. However there are circumstances where the Council may borrow money before it is required to finance capital expenditure, in accordance with the prudential code, and these circumstances provide additional balances for temporary investment. Any borrowing in advance of need will come at a cost and is not planned for 2011/12. However the Director for Corporate Support will monitor interest rates for both borrowing and investments and will react to changes in circumstances that make any advance borrowing that fits in with the Council's overall strategy and prudential indicators a viable option. This borrowing comes with additional credit risk by increasing the available funds for investments. This risk will be managed by depositing in high security institutions within limits set within the strategy.
- 10.4 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Non specified investments are regarded as higher risk than specified ones. The Council has traditionally invested in term deposits or call accounts, although the annual strategy statements have outlined a number of other specified and non specified instruments. Appendix C lists the specified and non specified investments available to be used for 2011/12.
- 10.5 The Council needs to maintain flexibility in its investment options if it is to be able to respond quickly to changing circumstances. Appendix C therefore continues to outline a number of investment instruments available for use in the coming year. The inclusion of such instruments on the list will afford the Director for Corporate Support, acting under delegated authority in accordance with the Constitution and in consultation with the Treasury Management Board, the flexibility required to manage the investment portfolio on a day to day basis without the need to seek prior Council approval for changes. Inclusion of an instrument on the list does not mean that the Council will necessarily make use of these during the year. The current lending list proposed to start on 1 April 2011 is attached at Appendix D. This will be reviewed with any banks no longer meeting the required credit quality criteria on 1 April removed from the list.
- 10.6 The Council's estimated levels of investments are set out in section 6.

11. Investment Strategy for 2011/12

- 11.1 The Council's in-house investments are made with reference to the outlook for the UK Bank Rate and money market rates. The Current Counter party list permits the Council to invest in:
- The Debt Management Agency Deposit Facility (DMO)
 - Term deposits or business reserve accounts with UK banks or building societies that have access to the UK Government Credit Guarantee scheme
 - UK nationalised banks
 - Deposits with other local authorities
 - Deposits with highly credit rated foreign banks, on the advice of Arlingclose (not currently used)
 - AAA-rated Money Market Funds (MMF) with a Constant Net Asset Value (Constant NAV) investing predominantly in government securities (not currently used)

- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) investing in instruments issued primarily by financial institutions (not currently used)

11.2 The Strategy for 2011/12 proposes that the following be included within the approved Counterparty list:

- AAA-rate Variable Net Asset Value (VNAV) Money Market Funds
- Treasury Bills (T-Bills)
- Term deposits in Sweden

The inclusion of additional investment instruments and organisations on to the Counter party list will increase the flexibility for the Director for Corporate Support to respond to market conditions. However new organisations and instruments would not be used without careful monitoring of the credit risk (see below) , and, liaison with our Treasury Advisors.

11.3 In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office (DMADF) or UK Treasury Bills. The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

11.4 The Council selects countries and the institutions within them for the counter party list after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+ for counterparties; AA+ for countries)
- Credit Default Swaps (where quoted)
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms/potential support from a well-resourced parent institution
- Share Prices
- Macro-economic indicators
- Corporate developments, news and articles, market sentiment.

11.5 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.

11.6 The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2011/12. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.

11.7 To protect against a lower for longer prolonged period of low interest rates and to provide certainty of income, 2-year deposits and longer-term secure investments will be actively considered during 2011/12. These will be limited to a maximum of £10m or one third of total investment, if this is lower, with any one banking group. The longer-term investments will be likely to include:

- Term Deposits with counterparties rated at least A+ (or equivalent)
- Supranational Bonds (bonds issued by multilateral development banks):- even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.

11.8 The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. No more than 25% of the Council's investment portfolio will be in term deposits exceeding 1 year at any one time.

Table 13 Prudential (Treasury) Indicator – upper limit for sums invested more than 364days

Upper Limit for total principal sums invested over 364 days	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
	25	25	25	25	25

11.9 The Council's updated lending list for 2011/12 is included at Appendix D. The list will continue to be reviewed and updated by the Director for Corporate Support during the year.

11.10 The target rate of return on new investment in 2011/12 is 1%. The current deposits include deposits which were taken out for longer-term prior to the Icelandic banking crisis and are at much higher rates than current deposit rates. Taking these deposits into account the average rate on all deposits in 2011/12 is forecast at 2.41%. The investment interest included in the 2011/12 budget is £0.839m. This does not take account of any repayments from our Iceland bank deposits.

11.11 Using the Arlingclose risk matrix, the Council will aim to achieve an overall credit rating of A+ or higher and a credit score of 5 or lower for its investment portfolio.

12. Investments defined as Capital Expenditure

12.1 The acquisition of share capital or loan capital in any body corporate, a loan or grant or financial assistance by the Council to another body for capital expenditure, and certain other types of investment are defined as capital expenditure under the relevant Regulations.

12.2 The Council's policy is to not use any investment which will be deemed capital expenditure.

13. Balanced Budget Requirement

- 13.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget. The proposed budget for 2011/12 is set out in the 2011/12 budget report.

14. Annual MRP Statement

- 14.1 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.

- 14.2 The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

- 14.3 MRP in 2011/12: 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).

- 14.4 Under the regulations, the authority is required before the start of each financial year to prepare a statement of its policy on making MRP in respect of that financial year and submit it to the Full Council. The proposed policy for 2011/12 is as follows:

Supported Borrowing

For borrowing supported by Revenue Support Grant the Council will continue to use the current method of 4% of the adjusted Non-HRA capital financing requirement, (Option 2).

Unsupported Borrowing

For new borrowing under the prudential system for which no Government support is being given and is therefore self-financed, MRP will be made in equal annual instalments over the life of the asset (Option 3).

Capitalisation Directions

For capitalisation directions on expenditure incurred since 1 April 2008 MRP will be made in equal annual instalments over 20 years in line with DCLG guidance (Option 3).

PFI/Leases

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.

In all cases MRP will commence in the financial year following the one in which the expenditure is incurred.

15. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

- 15.1 In accordance with the recommendations of the Treasury Management Code, the Council's Audit Committee will be responsible for the scrutiny of treasury management activities and practices.
- 15.2 The Director for Corporate Support will report to the Audit Committee on treasury management activity and performance at least twice a year against the strategy approved for the year (being a mid year review and an end of year review).
- 15.3 The Council is required to produce an outturn report on its treasury activity no later than 30 September after the financial year.
- 15.4 In addition treasury management activity will continue to be reported as part of the quarterly budget and performance reports to Cabinet and as part of the budget outturn report. The Prudential Indicators will be presented to Cabinet as part of the annual budget report.

16. Other Items

16.1 Training

CIPFA's Code of Practice requires the Director of Corporate Support 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. Members of the Audit Committee received training in Treasury Management in January 2010. Council Officers provided refresher training for members on 10 January 2011.

16.2 Investment Consultants

The CLG's Guidance on local government investments recommend that the Investment Strategy should state:

- whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and
- how the quality of any such service is controlled.

The Council continues to use Arlingclose as its treasury advisors. Arlingclose attend the Council Offices and meet with the Treasury Management Board at least quarterly to discuss the Council's borrowing and investment strategies and update on any new developments. The Council also receives regular updates concerning its counter party institutions, including any new institutions that may be added to the counter party list.

During 2010/11 Arlingclose developed a set of benchmarking criteria which enables the Council to compare its investment performance against other Unitary Council clients of Arlingclose.

The contract with Arlingclose commenced on 1 January 2009 and was for an initial period of 1 year, extendable by a further 1 plus 1 year subject to satisfactory performance. The contract will be subject to re-tender by 31 December 2011.

17. Recommendations

- 17.1 To approve the Treasury Management Strategy Statement for 2011/12.
- 17.2. To approve the Investment Strategy for 2011/12 as outlined in Section 11 of the report.
- 17.3. To approve the Lending Organisations and Counter party Limits as outlined in Appendix D
- 17.44. To request the Director for Corporate Support, acting under delegated authority in accordance with the Constitution, to keep the lending list under review and update the list during the year as dictated by market circumstances.
- 17.5. To recommend to full Council, subject to update following any revision to the capital programme
 - (a) The Prudential Indicators set out in the report
 - (b) The Authorised Borrowing limits of £379m, £376m and £373m for the period 2011/12 to 2013/14
 - (c) The Operational Boundary of £355m, £347m and £334m for 2011/12 to 2013/14
 - (d) The MRP Policy for 2011/12