TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2011/12

1 SUMMARY

1.1 This report sets out the Council's Treasury Management Strategy for borrowing and investment for 2011/12.

1.2 Treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

2 INTRODUCTION

2.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy, as required by Investment Guidance issued subsequent to the Act (included as paragraph 9 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

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

2.4 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 26 January 2010.

2.5 The suggested Strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the Head of Finance's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor.

2.6 The Strategy covers:-

- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential & Treasury Indicators;
- The current treasury position;

- The borrowing requirement;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need
- Debt rescheduling
- The investment strategy
- Creditworthiness policy
- Policy on use of external service providers.
- The MRP strategy

3 BALANCED BUDGET REQUIREMENT

3.1 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:-

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- Any increases in running costs from new capital projects

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

4 TREASURY LIMITS FOR 2011/12 TO 2013/14

4.1 It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

4.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

4.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details can be found in table 2 of this report.

5 CURRENT PORTFOLIO POSITION

5.1 The Council's treasury portfolio position at 7 January 2011 comprised:-

	Balance £M	Average Rate %
Borrowing	-	-
Investments	8.0	1.34

6 BORROWING REQUIREMENT

6.1 The Council's borrowing requirement for the period 2011/12 to 2013/14 is currently forecast to be zero.

6.2 However, as part of the capital strategy, the Council is starting to consider purchasing property whilst the market is low. If this proceeds then borrowing may be required; however this may be funded by internal funds. As this has not yet been approved, it has not been considered when setting the prudential indicators around the capital programme within this Strategy, and has not been included in the borrowing requirement above.

6.3 The Head of Finance as the Chief Finance Officer (Section 151 Officer) decides on the most appropriate method of financing the Capital Programme. In the current economic environment, with low interest rates, it may be more cost effective to finance capital expenditure by external borrowing but this will be on the advice of our treasury management advisors and will be reported to the following Council.

7 PRUDENTIAL AND TREASURY INDICATORS FOR 2011/12 – 2013/14

7.1 Prudential and Treasury Indicators as set out below are relevant for the purposes of setting an integrated treasury management strategy.

TABLE 1: PRUDENTIAL INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
Extract from budget and rent setting report	actual	probable outturn	estimate	estimate	estimate
	£000s	£000s	£000s	£000s	£000s
Capital Expenditure	1,201	1,297	1,567	772	501
Ratio of financing costs to net revenue stream	-1.3%	-0.6%	-0.7%	-2.1%	-3.9%
Net borrowing requirement					
brought forward 1 April	0	0	0	0	0
carried forward 31 March	0	0	0	0	0
in year borrowing requirement	0	0	0	0	0
Capital Financing Requirement as at 31 March	(9,848)	(9,848)	(9,848)	(9,848)	(9,848)
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum	(0.03)	(0.41)	0.31	0.01	(0.01)

TABLE 2: TREASURY MANAGEMENT INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
	actual	probable outturn	estimate	estimate	estimate
	£000s	£000s	£000s	£000s	£000s
Authorised Limit for external debt -					
Borrowing	-	6,500	7,000	6,500	6,500
Other long term liabilities	39	32	25	18	11
TOTAL	39	6,532	7,025	6,518	6,511
Operational Boundary for external debt -					
borrowing	-	4,205	4,409	4,623	4,848
other long term liabilities	39	32	25	18	11
TOTAL	39	4,237	4,434	4,641	4,859
Actual external debt	39	32	25	18	11
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing/investments:-		8,000	8,000	8,000	8,000
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments:-	-	6,000	5,000	5,000	6,000
Upper limit for total principal sums invested for over one year	-	3,000	3,000	3,000	3,000

Maturity structure of new fixed rate borrowing during 2008/09	Upper limit	Lower limit
Under 12 months	0%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%
No borrowing expected to be taken in 2011/12		

7.2 **Authorised Limit**

The authorised limits set out are consistent with the Council's current commitments, existing plans and the proposals for capital expenditure and financing and with its approved treasury management policy statement and practices. This limit should not be exceeded and is, therefore, based on a prudent assessment taking account of the worst-case scenario. They are currently based on an assumption that there will be no long term borrowing to fund capital expenditure and that the only borrowing will be to fund short term cash flow needs.

7.3 **Operational Boundary**

The operational boundary limits set out are based on the authorized limits but reflect the more likely level of borrowing to meet cash flow requirement, without the additional headroom included within the authorized limit to allow, for example, for unusual cash movement. This indicator may be breached temporarily for operational reasons.

7.4 **Capital Financing Requirement (CFR)**

The CFR is an indication of the Council's requirement to borrow for capital purposes.

8 PROSPECTS FOR INTEREST RATES

8.1 The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Their current view, based on the assessment of various forecasts, is average rates for the financial years as follows:-

- 2010/2011 0.50%
- 2011/2012 1.00%
- 2012/2013 2.25%
- 2013/2014 3.25%

8.2 There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

9 Borrowing Strategy

9.1 The Sector forecast for the PWLB new borrowing rate is as follows:-

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5yr PWLB rate	3.00%	3.00%	3.10%	3.20%	3.30%	3.50%	4.40%	5.00%
10yr PWLB rate	4.10%	4.10%	4.10%	4.20%	4.30%	4.40%	5.00%	5.40%
25yr PWLB rate	5.00%	5.10%	5.20%	5.30%	5.30%	5.40%	5.50%	5.70%
50yr PWLB rate	5.10%	5.20%	5.30%	5.40%	5.40%	5.50%	5.60%	5.70%

9.2 The Council has no plans to borrow funds as the Capital Programme is fully funded from capital receipts and the cost of borrowing exceeds the interest earned on investments.

9.3 However, the financing requirements for capital expenditure will be regularly reviewed and consideration may be given to external borrowing if the overall forecast is for long term borrowing rates to increase over the next few years and there is an advantage in considering long term financing costs against the short term advantage of internal borrowing. The Head of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, including moving financing to prudential borrowing, reporting any decisions to Council at the next available opportunity.

9.3 **Sensitivity of the forecast**

The Council's officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts.

9.4 It is a requirement under the new code to explain the difference between gross debt (i.e. total borrowing) and net debt (borrowing less investments). As there is no external borrowing, this indicator is zero.

10 POLICY ON BORROWING IN ADVANCE OF NEED

10.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

10.2 In determining whether borrowing will be undertaken in advance of need the Council will:-

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

11 ANNUAL INVESTMENT STRATEGY

Investment Policy

11.1 The Council will have regard to the Government's Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:-

- the security of capital and
- the liquidity of its investments.

11.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

11.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

11.4 Specified Investment instruments identified for use in the financial year remain the same as those agreed for 2010/11 and are listed below:-

- Debt Management Agency Deposit Facility (Government Managed)
- (Government Managed)
- Term deposits – UK government
- Term deposits – other Local Authorities
- Term deposits – banks and building societies
- Money Market Funds

Creditworthiness policy

11.5 This Council uses the creditworthiness service provided by Sector. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:-

- Credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy countries

11.6 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved indication of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

11.7 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions within Sector's weekly credit list of worldwide potential counterparties.

11.8 In order to minimise risk and maintain diversity, the Council will have a limit in the amount which can be placed in an institution. This limit will also apply to groups. For example, the Bank Santander includes Abbey National, Cater Allan and Alliance & Leicester. Because the value of investments held at any time can vary by up to £6m, depending on cash flow requirements, it is not considered practical to have a percentage limit. The limits will be linked to duration and be as follows:-

Sector Colour Coding	**Maximum Duration**	**Maximum Investment**
Purple	2 years	£3m
Blue (nationalised or semi nationalised UK Banks)	1 year	£4m
Orange	1 year	£1m
Red	6 months	£3m
Green	3 months	£6m
No Colour	Not to be used	0

Organisation	**Maximum Duration**	**Maximum Investment**
Debt Management Office (Government Body)	3 months	£14m
Co-operative Bank – Reserve Account. The Council's main banker	On call (can be withdrawn immediately)	£2m
Money Market Funds – AAA long-term credit rating	On call (can be withdrawn immediately)	£2m per fund

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

11.10 All credit ratings will be monitored as new information comes to light. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

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

12 INVESTMENT STRATEGY

Country Limits

12.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide)

12.2 All Countries other than the UK will be subject to a £3m investment limit for a duration of up to one year.

Investment Management

12.3 The Council does not use a fund manager and funds are managed in-house. Investments will accordingly be made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

12.4 **Interest rate outlook**: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast to commence rising in quarter 4 of 2011 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows:-

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

There is downside risk to these forecasts if economic growth is weaker than expected. There is also a risk that the Bank Rate could rise earlier.

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

12.6 The Council will also seek to utilise its business reserve accounts, 15 and 30 day accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

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

13 POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

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

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

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

14 SCHEME OF DELEGATION

14.1 Under the Code, the Council is required to specify its Scheme of Delegation for Treasury Management and the responsibilities of the Head of Finance, as the Section 151 Officer, and this is shown below:-

(i) Council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.
- budget consideration and approval
- receiving the end of year report on treasury management

(ii) Executive

- approval of/amendments to the organisation’s adopted clauses, treasury management policy statement and treasury management practices
- approval of the division of responsibilities

- receiving and reviewing regular monitoring reports and acting on recommendations

(iii) Audit committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iv) Head of Finance (Section 151 officer)

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- approving the selection of external service providers and agreeing terms of appointment.

15 MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT 2011/12

15.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the years in which it was incurred, and therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision.

15.2 The Council is required to agree a Statement on the Council's policy for its annual MRP before the start of the year to which the provision will relate. This Statement is prepared in line with the Guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003 which was revised and updated from April 2008. The Guidance offers four main options under which MRP could be made.

15.3 In particular, the Council are satisfied that the guidelines for their annual amount of MRP set out within this Policy Statement will result in their not having to make any requisite prudent provision that is required by the Guidance.

15.4 For 2011/1, it is proposed to use the Capital Financing Requirement Method which is based upon a charge of 4% of the Council's CFR as at the previous 31 March, less any reductions stipulated by regulation. The CFR is a measure of the Council's outstanding financing requirement, including internal borrowing and is calculated from the Balance Sheet. The Council has reviewed its MRP liability in line with the Regulations and for 2011/12 it is anticipated that there will be negative CFR which means no requirement for an MRP charge.

15.5 The MRP Guidance recommends that for expenditures incurred prior to the implementation of the Guidance, MRP should be assessed in accordance with the previous statutory requirements.

15.6 A review of MRP made in 2007/08 and 2008/09 has been carried out with advice from Sector that the MRP did not need to be made, and therefore can be reversed out during the closure of the 2010/11 accounts.

16 RISK IMPLICATIONS

16.1 It is necessary to outline the risks involved in the investments made by the Council. There is of course always a risk that a building society or bank may fail during the duration of an investment but this is considered less likely where the institution has a minimum credit rating as specified in our Investment Strategy. Although the Government have provided assistance and guarantees where banks have encountered problems which have threatened their future, this cannot be guaranteed for the future.

16.2 With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is, however, the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. Therefore, no investments for more than 1 year will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment.

16.3 The Council may use Money Market Funds from AAA-rated institutions for cash balances. These are funds with the highest credit rating, providing excellent security for the Council's money. Surplus balances not invested in pure cash deposits can earn a rate similar to 1 month London Interbank Bid Rate, and funds can be accessed with minimal notice. Returns are not fixed, however, and will rise and fall in line with the market. As a result, these funds will not be used to take a view on the likely future path of interest rates, or as a protection against falling rates. Their natural use is for balances too small to place with banks and building societies, or as an alternative to a bank call account. No investments will be made in Money Market Funds without the advice of our Treasury Consultants.

16.4 The treasury management function cannot take place without an agreed Treasury Management Strategy in place before the start of the financial year.

16.5 Reputation Risk - The Council is responsible for managing the investment of public funds and must be seen to be adopting a pragmatic and prudent approach.

17 RESOURCE IMPLICATIONS

17.1 All interest paid and received is accounted for within the General Fund. Investment income used to be a material source of income to the Council. The amount of income generated is dependent upon interest rates and level of balances. The fall in investment income has been taken into account in the Medium Term Financial Strategy.

18 RECOMMENDATION

18.1 It is proposed that the Council **RESOLVES**

(1) To agree the Treasury Management Strategy Statement and Annual Investment Strategy including the limits contained within the report.

(2) To agree the MRP policy for 2011/12 and adjustments to the MRPs for 2007/08 and 2008/09.

(3) To agree the Authorised Limit and Operational Boundary for external debt as laid down in the report and delegate authority to the Head of Finance within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities.

Yvonne Woodward

Head of Finance

Background Papers:-

CIPFA Prudential Code for Capital Finance in Local Authorities (Revised Edition 2009)

CIPFA’s Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (Revised Edition 2009)

Local Government Act 2003

ODPM’s Guidance on Local Government Investments March 2004

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