TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2009/10

1 SUMMARY

1.1 This report sets out the Council's treasury strategy for borrowing and investment for 2009/10.

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 7); 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 suggested Strategy for 2009/10 in respect of the following aspects of the treasury management function is based upon the finance officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The Strategy covers:-

- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- The current treasury position;
- The borrowing requirement;
- Prospects for interest rates;
- The borrowing strategy;
- The investment strategy.

2.4 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.

3 TREASURY LIMITS FOR 2009/10 TO 2011/12

3.1 It is a statutory duty under S3 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 section 3 of the Local Government Act 2003.

3.2 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'.

3.3 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.

4 PRUDENTIAL INDICATORS FOR 2009/10 – 2010/11

4.1 The following prudential indicators (in Table 2 below) are relevant for the purposes of setting an integrated treasury management strategy. The Indicators in Table 1 also appeared in the Budget setting report, with more detailed explanations.

4.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The full Council adopted this on 19 December 2002.

TABLE 1 - BUDGET AND RENT SETTING PRUDENTIAL INDICATORS	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
	Actual	**Probable outturn**	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
General Fund Total	693	3,234	1,412	1,224	535
	£	£	£	£	£
Incremental Impact on Council Tax (per Band D) per year	(0.42)	(0.11)	0.90	0.65	0.05
Ratio of financing costs to net revenue stream					
General Fund	(3%)	(8%)	(3%)	(3%)	(3%)
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
New borrowing requirement	-	-	-	-	-
Capital Financing Requirement as at 31 March	550	550	550	550	550
Annual change in Capital Financing Requirement.		-	-	-	-

TABLE 2 – TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
	Actual	**Probable outturn**	**Estimate**	**Estimate**	**Estimate**
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing (includes overdraft to cover risk of interrupted cashflows)	-	3,732	5,400	6,700	7,400
Other long term liabilities	65	59	53	47	41
TOTAL	65	3,791	5,453	6,747	7,441
Operational boundary for external debt					
Borrowing			1,500	2,700	3,200
Other long term liabilities	65	59	53	47	41
TOTAL	65	59	1,553	2,747	3,241
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	-	3,732	5,500	6,800	7,500
Upper limit for variable rate exposure					
Net principal re variable rate borrowing/investments	(12,516)	(18,000)	(18,000)	(18,000)	(18,000)

The authority does not invest for periods over 364 days.

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 taken or envisaged to be needed in 2008/09.		

4.3 Due to the authority going through the LSVT process in 2007/08, the relevant indicators for the HRA for 2007/08 have not been included in the above tables. The relevant figures can be obtained from the Council on enquiry to the finance department.

5 CURRENT PORTFOLIO POSITION

5.1 The Council's treasury portfolio position at 2 January 2009 comprised:-

	Balance £M	Average Rate %
Borrowing	-	-
Investments	12,341	5.81

6 BORROWING REQUIREMENT

	2007/08	2008/09	2009/10	2010/11	2011/12
	£'000 Actual	**£'000 Probable**	**£'000 Estimate**	**£'000 Estimate**	**£'000 Estimate**
New borrowing	3,300	-	1,500	1,200	500
Alternative financing arrangements	-	-	-	-	-
Replacement borrowing	-	-	-	-	-
TOTAL	3,300	-	1,500	1,200	500

6.1 The authority went debt free in October 2007 and it is not anticipated that any new borrowing will be required in the short term to fund the capital programme.

6.2 However as part of the capital strategy, the Authority 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, but has been included in the borrowing requirement above.

6.3 The Head of Finance, Audit and Performance Management (HFAPM), as the Chief Finance Officer, can decide on the most appropriate method of financing the Capital Programme. Although unlikely in the current economic environment, where there is little incentive to maintain balance, if borrowing is taken, this will be on the advice of our treasury management advisors and will be reported to the next Council.

Prospects for Interest Rates

6.4 The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view as at 6 December 2008, (following this view the Bank of England cut interest rates to 1.5% on 8 January, figures were not revised in time for inclusion in this report):

	2009				2010				2011				2012
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Base Rate (%)	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.75	2.50	3.25	3.75	4.00
5yr PWLB rate (%)	2.50	2.25	2.15	2.15	2.15	2.45	2.80	3.15	3.65	3.95	4.20	4.45	4.60
10yr PWLB Rate (%)	3.10	2.75	2.55	2.55	2.55	2.85	3.25	3.65	4.15	4.40	4.70	4.75	4.85
25yr PWLB Rate (%)	4.00	3.95	3.95	3.95	4.00	4.15	4.35	4.45	4.60	4.85	4.95	5.00	5.05
50yr PWLB rate (%)	3.85	3.80	3.80	3.80	3.85	3.90	4.00	4.25	4.40	4.70	4.80	4.95	5.00

(PWLB refers to the Public Works Loans Board)

6.5 Sector's current interest rate view is that Bank Rate:-

- will fall from current levels because of the intensifying global recession
- Starting 2009 at 2.00%, Bank Rate is forecast to fall to 0.5% in Q1 2009
- It is then expected to remain there until starting to rise gently up from Q2 2010 till it reaches 4.0% in Q1 2012.
- There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

Borrowing Strategy

6.6 The Sector forecast is as follows. (These forecasts are based around an expectation that there will normally be variations of +/- 25base points (bp) during each quarter around these average forecasts in normal economic and political circumstances. However, greater variations can occur if should there be any unexpected shocks to financial and/or political systems.) These forecasts are for the PWLB new borrowing rate:-

- The 50 year PWLB rate is expected to remain around current levels of about 3.80 - 3.90% until Q2 2010 when it is forecast to rise to 4.00%. The rate then edges up gradually to reach 5.00% at the end of the forecast period.

- The 25 year PWLB rate is expected to drop to 3.95% in Q1 2009 and stay around there until starting to rise in Q1 2010 and then to eventually reach 5.05% at the end of the forecast period.

- The 10 year PWLB rate is expected to drop to 2.55% in Q3 2009 but then to start rising again in Q2 2010 to eventually reach 4.85% at the end of the forecast period.

- The 5 year PWLB rate is expected to fall to a floor of 2.15% during Q3 2009. The rate then starts rising in Q2 2010 to eventually reach 4.60% at the end of the forecast period.

6.5 This forecast indicates, therefore, that there is a range of options available for borrowing strategy for 2009/10. Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to simply taking long term fixed rate borrowing. Under 10 year PWLB rates are expected to be substantially lower than longer term PWLB rates so this will open up a range of choices for new borrowing for authorities that want to spread their debt maturities away from a concentration in long dated debt. Rates are expected to be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.

6.6 For authorities wishing to minimise their debt interest costs, the main strategy is therefore as follows:-

- For authorities wanting to focus on the very cheapest PWLB borrowing, the under 10 year rates will provide significantly cheaper rates than longer term borrowing. Under 5 year rates are also expected to be significantly lower than 5-10 year rates. Rates are expected to be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.
- For authorities wanting to lock into historically low long term rates, there is expected to be little difference between 25 year and 50 year rates. However, despite the minimally more expensive new borrowing rates expected in the 25 – 30 year period later in the year, these could be seen as being much more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This then maximises the potential for debt rescheduling at a later time by minimising the spread between these two rates.
- This strategy would also mean that after some years of focusing on borrowing at or near the 50 year period, local authorities would be able to

undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.
- When long term PWLB rates fall back to the central forecast rate of about 3.95%, borrowing should be made at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 3.95%. The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes that the PWLB may introduce to their lending policy and operations.
- Consideration may also be given to borrowing fixed rate market loans at 25 – 50 basis points below the PWLB target rate if they become available again.

External v. internal borrowing

- The next financial year is expected to be a time of historically abnormally low Bank Rates. This opens up an opportunity for authorities to fundamentally review their strategy of undertaking external borrowing.
- For those authorities with investments in excess of their borrowing requirement over the next year and access to the cash from maturing investments within the financial year, then consideration also needs to be given to the potential merits of internal borrowing.
- As long term borrowing rates are expected to be higher than rates on the loss of investment income and look likely to be so for the next couple of years or so, authorities may prefer to avoid all new external borrowing in the next financial year in order to maximise savings in the short term.
- The running down of investments also has benefits of reducing exposure to interest rate and credit risk.

6.7 Against this background caution will be adopted with the 2009/10 treasury operations. The Capital Programme is financed currently by the use of capital receipts. The Head of Finance, Audit and Performance Management 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.

7 ANNUAL INVESTMENT STRATEGY

Investment Policy

7.1 The Council will have regard to the Government's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's 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.

7.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

7.3 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.

7.4 Investment instruments identified for use in the financial year are listed below under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.

Specified Investments:

7.5 Investment instruments identified for use in-house in the financial year remain the same as those agreed last year, and are listed below.

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

7.6 For 2008/09, the Council added non-UK clearing Banks and Building Societies to the list of authorised organisations in order to enable maximum return on investments. In light of the current economic climate, the criteria have been kept tight and will be monitored for potential changes. The credit rating of the country is also taken into consideration.

7.7 The Council uses Fitch ratings to derive its organisation criteria. Where an organisation does not have a Fitch rating, the equivalent Moody’s rating will be used. All credit ratings are monitored monthly and the Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. If a downgrade results in the organisation/investment scheme no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately. If a counterparty is put on ratings watch, pending a review of its credit rating, the HFAPM will review the circumstances and it may be withdrawn.

7.8 The approved Organisation list is determined by the following minimum criteria; this has been revised significantly from the list in the previous years strategy and has already been subject to review by the Executive for an interim strategy due to the current economic climate. These are minimum criteria and meeting these does not guarantee admission to the counterparty list. The HFAPM will take into account other factors, less subjective, when deciding changes to the list.

ORGANISATION	CRITERIA	MAX AMOUNT	MAX PERIOD
U.K. Clearing Bank & U.K. Building Society	Minimum F1+ or P1 short term backed up by AAA long-term credit rating individual rating B.	£3M	3 Years
U.K. Clearing Bank & U.K. Building Society	Minimum F1 or P1 short term backed up by AA- long-term credit rating, and individual rating B/C or, if part of a group, support rating of 1. PLUS If part of a group – Parent Group – Minimum F1+ short term backed up by AA long term credit rating and individual rating B.	£7M	1 year
U.K. Clearing Bank & U.K. Building Society	Minimum F1 or P1 short term backed up by A long-term credit rating, individual rating B or if part of a group, support rating of 1. PLUS If part of a group – Parent Group – Minimum F1+ short term backed up by A long term credit rating and individual rating B.	£3M	3 Months
Government guaranteed bodies	100% guarantee in place for wholesale deposits Country rating of AAA	£10M	Length of Guarantee period or notice period of termination of guarantee
U.K. Local Authorities		£7M	1 year

ORGANISATION	CRITERIA	MAX AMOUNT	MAX PERIOD
Other U.K. Financial Institutions & Government Bodies	Minimum F1+ short term backed up by AA+ long-term credit rating and support rating of 1.	£7M	1 year
Debt Management Office (Government Body)		£20M	3 months
Money Market Funds	Minimum AAA long-term credit rating.	£7M	1 year
Non UK Clearing Bank and Building Society Part of Group	Minimum F1 or P1 short term backed up by AA- long-term credit rating, and individual rating B. Country's rating of AAA	£3M	1 year
Non UK Clearing Bank and Building Society Part of Group	Minimum F1 or P1 short term backed up by AA long-term credit rating and support rating of 1. Parent Group – Minimum F1+ short term backed up by AA long term credit rating and individual rating B Country's rating of AAA	£3M	1 year

7.9 Organisations will continue to be monitored against the above criteria by the treasury team and Section 151 officer (HFAPM). Should any deviations be required then the S151 officer is delegated to make such decisions and if thought necessary will be reported to the Executive.

Investment Strategy

7.10 The Council does not use a fund manager and the funds managed in-house are a split between those cashflow derived and core balances. 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).

7.11 The Bank Rate started on a downward trend from 5.75% in December 2007 with further cuts of 0.25% in February and April 2008, then 0.5% in October, 1.5% in November, 1% in December and 0.5% in January 09. Sector are forecasting further cuts of 1.0% during Q1 2009. It is then expected to stabilise at 0.50% until starting to rise gradually with the first increase in Q2 2010 and then to be back up to 4.00% during Q1 2012.

7.12 The Council will, therefore, seek to avoid locking into longer term deals while investment rates are down at historically low levels. Investment income for 2009/10 is budgeted at 2.5%.

7.13 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight-3 months) in order to benefit from the compounding of interest.

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

8 MINIMUM REVENUE PROVISION POLICY STATEMENT 2009/10

8.1 The Council implemented the new Minimum Revenue Provision (MRP) guidance via a statement to Council in June 2008 for the financial years 2007/08 and 2008/09.

8.2 For 2009/10 it is proposed, that the same method chosen for 2008/09 is used. This is the asset life method and makes a provision for repayment of borrowing for the asset over the life of the asset. As in 2008/09, as the capital programme is not financed by any borrowing, a voluntary provision has been included in the budget book to increase the total MRP for 2009/10 to £45,000. This includes the old regulatory charge for MRP on assets held by the authority prior to April 2008.

8.3 Where relevant, the estimated life of assets will be determined by finance officers and officers related to the asset. MRP will not be charged until the year after large assets become operational, this is in line with regulations.

8.4 As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

9 RISK IMPLICATIONS

9.1 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.

9.2 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.

9.3 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.

Resource Risk

9.4 Investment income used to be a material source of income to the Authority. 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.

Regulatory and Operational Risk

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

Reputation Risk

9.6 The Authority is responsible for managing the investment of public funds and must be seen to be adopting a pragmatic and prudent approach.

10 RESOURCE IMPLICATIONS

10.1 All interest paid and received is accounted for within the General Fund.

11 RECOMMENDATION

11.1 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 Authorised Limit and Operational Boundary for external debt as laid down in the report and delegate authority to the Head of Finance, Audit and Performance Management, 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, Audit and Performance Management

Background Papers:-

CIPFA Prudential Code CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes Local Government Act 2003 ODPM's Guidance on Local Government Investments March 2004.

For further information please contact Carrie Watkins on:-

Tel:- 01702 546366
E-Mail:- carrie.watkins@rochford.gov.uk