
TREASURY MANAGEMENT STRATEGY STATEMENT 2004/05 AND PRUDENTIAL INDICATORS FOR CAPITAL EXPENDITURE

1 SUMMARY

- 1.1 This report covers the setting of Prudential Indicators and the Treasury Management Strategy for 2004/05.

2 INTRODUCTION

- 2.1 In accordance with the Council's Constitution, the Corporate Director (Financial & External Services) is required to report annually on the strategy for treasury management for the coming financial year. The 2003 Prudential Code for Capital Finance in Local Authorities has introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.
- 2.2 The Prudential Code requires the Council to set a number of Prudential Indicators, certain of which replace the borrowing/variable interest limits previously determined as part of the strategy statement, whilst also extending the period covered from one to three years. This report does therefore incorporate the indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years.
- 2.3 The suggested strategy for 2004/05 in respect of the following aspects of the treasury management function is based upon views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Sector Treasury Services Ltd. The Council has appointed treasury consultants, Sector Treasury Services Ltd, to provide advice on the strategic and operational management of its treasury management function.

The strategy covers:

- the current treasury position;
- treasury limits in force which will limit the treasury risk and activities of the Council;
- the borrowing strategy;
- the investment strategy;
- the extent of debt rescheduling opportunities;

3 CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position at 31/12/03 comprised:

	Balance £m	Average Rate %
Fixed Rate Loans - PWLB Principal	11.4	9.80
Variable Rate Loans	-	-
Investments	13.1	3.83

4 TREASURY LIMITS FOR 2004/05 TO 2006/07

- 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".
- 4.2 The Council must have regard to the Prudential Code when setting their Affordable Borrowing 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/rent levels is 'acceptable'. The Affordable Borrowing limit is set on a rolling basis for the forthcoming year and two successive years. It takes the capital programme agreed in January 2004 as the base and assesses the effect on council tax/rents of the programme for the two successive years.
- 4.3 The current capital programme was agreed on the basis that it complied with the budget strategy, which includes projected council tax increases.

5 PRUDENTIAL INDICATORS 2004/05 – 2006/07

- 5.1 The objective of the Code is to provide a framework for local authority capital finance that will ensure that:
- Capital expenditure plans are *affordable*
 - All external borrowing and other long term liabilities are within *prudent and sustainable levels*
 - Treasury management decisions are taken in accordance with professional good practice

The Code includes a framework for setting up a number of prudential indicators. Some of these indicators replace the Aggregate Credit Limit previously determined as part of the strategy statement, whilst also extending the period covered from one to three years.

- 5.2 The indicators are purely for internal use by the Council and are not to be used as comparators between councils as any comparisons will be meaningless. In addition the indicators should not be viewed individually;

rather the benefit from monitoring will arise from following the movement in indicators over time and the year on year changes.

5.3 Capital Expenditure and the Capital Financing Requirement

The actual capital expenditure that was incurred in 2002/03 and the estimates of capital expenditure to be incurred for the current and future years was agreed at Council on 27th January 2004, as follows:

	2002/03 Actual £'000	2003/04 Estimate £'000	2004/05 Estimate £'000	2005/06 Estimate £'000	2006/07 Estimate £'000
HRA	887	1,440	1,230	1,279	1,265
Other Housing	423	765	328	328	178
General Fund	1,003	970	764	212	148
Park Sports Centre	-	-	1,000	1,800	-
Total	2,313	3,175	3,322	3,619	1,591

5.4 A change introduced by the Code is the calculation of the Capital Financing Requirement (CFR). This figure represents the Council's underlying requirement to finance its current and historic capital expenditure, which has not been charged to revenue. The change year on year will be influenced by the capital expenditure within the year.

5.5 The Council's expectations for the CFR in the next 3 years are shown below. This is one of the required prudential indicators.

	31/03/2003 Actual £'000	31/03/2004 Estimate £'000	31/03/2005 Estimate £'000	31/03/2006 Estimate £'000	31/03/2007 Estimate £'000
Total	9,668	10,271	11,401	13,374	13,432

This indicator is designed to measure the underlying need to borrow, or finance by other long-term liabilities, capital expenditure. Although this measures the need for borrowing, the borrowing may not necessarily take place externally. It may be considered prudent to make use of cash already invested for long-term purposes, for example, earmarked reserves and general fund balances. This is often known as 'internal borrowing' and means there is no immediate link between the need to borrow and the level of external borrowing. This is not actually using those funds, only making better use of the cash available.

5.6 Apart from £1.8m in respect of Park Sports Centre in 2005/06, it is not anticipated that it will be necessary to borrow to finance the capital programme, although temporary short-term borrowing may have to be undertaken for cash flow purposes.

6 AFFORDABILITY INDICATORS

6.1 Within the Prudential Framework, indicators required to assess the affordability of capital investment plans. These provide an indication of the impact of the capital programme on the overall Council finances. The Council is asked to approve the following indicators.

6.2 **Ratio of Financing Costs to Net Revenue Stream** – This indicator identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the net revenue stream. A negative figure represents a contribution to the revenue budget from investment income.

%	2002/03 Actual	2003/04 Estimate	2004/05 Estimate	2005/06 Estimate	2006/07 Estimate
HRA	31	23	21	21	21
General Fund	(6)	(4)	(4)	(3)	(3)

6.3 Estimates of the incremental impact of capital investment decision on the Council Tax/Housing Rents

This indicator identifies the trend in the cost of implementing changes in the 3-year capital programme compared to the existing commitments in the 2003/04 capital programme.

Increase/(Decrease)	2004/05 Estimate	2005/06 Estimate	2006/07 Estimate
Council Tax (band D, per annum)	0.47	0.79	(1.85)
Housing Rent per annum	(6.22)	(5.13)	(5.44)

6.4 It must be stressed that these are only to be used as indicators and do not represent actual increases or decreases in Council Tax or Housing Rents.

6.5 In future years, the preparation of the Capital Programme will include Option Appraisal of the items for inclusion which will assess how each item meets the objectives of the Prudential Code for affordability, prudence and sustainability. The methodology for Option Appraisal will be developed over the coming months and submitted to Council for approval.

6.6 Net Borrowing and the Capital Financing Requirement

6.7 The Prudential Code include the following as a key indicator of prudence:

“In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceeding year plus the estimates of any additional capital financing requirement for the current and next two financial years.”

The Council have met this requirement in 2003/04 and no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans and the current budget strategy.

- 6.8 In terms of the affordability to the Council, the real test is whether the expenditure in relation to new borrowing has been included within the Budget Strategy. Prudential borrowing is only planned in connection with Park Sports Centre and this is included within the Budget Strategy.

7 TREASURY MANAGEMENT STRATEGY AND ANNUAL PLAN FOR 2004/05

- 7.1 Rochford District Council has adopted the CIPFA *Code of Practice for Treasury Management in the Public Services* (this is a prudential indicator).

Capital Borrowings And The Borrowing Portfolio Strategy

- 7.2 In previous years an Aggregate Credit Limit has been agreed by Council as the amount which can be outstanding as borrowing. The Prudential Framework dispenses with this requirement. For the forthcoming financial year, it is proposed that temporary borrowing may be undertaken only for short-term cash flow requirements and this will be limited to £2m at variable rates. This is in line with past arrangements.
- 7.3 Other than temporary borrowing, 100% of the external debt of the Authority is from the Public Works Loan Board (PWLB) at fixed rates. The position on PWLB loans for 2003/04 to 2004/05 is as follows:

Description	2003/2004 £'000	2004/2005 £'000
Opening Balance	11,573	11,216
Less Repayments	357	357
Plus Additional Loans	-	-
Closing Balance	11,216	10,859

8 EXTERNAL DEBT

- 8.1 The Prudential Code requires the setting of two limits related to External Debt. The **Authorised Limit for External Debt** is the total external debt gross of investments. The Limit is based on current commitments, existing capital and revenue strategies for capital expenditure and financing. They are based on the estimate of most likely, prudent but not worst case scenario, with sufficient headroom to allow for operational management, for example cash movements. The limit determined for 2004/05 will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

	2003/04 £'000	2004/05 £'000	2005/06 £'000	2006/07 £'000
Borrowing	14,340	15,859	17,206	15,384
Other long term liabilities	146	110	90	70
Total	14,486	15,969	17,297	15,454

- 8.2 The Council is also asked to approve an **operational boundary for external debt**. This is based on the same estimates as the authorised limit but does not include the additional headroom to allow for unusual cash movements.

	2003/04 £'000	2004/05 £'000	2005/06 £'000	2006/07 £'000
Borrowing	11,573	11,216	12,659	10,502
Other long term liabilities	146	110	90	70
Total	11,719	11,326	12,749	10,572

- 8.3 Both these limits separately identify borrowing from other long term liabilities and the Council is asked to approve these limits and to delegate authority to the Head of Financial Services, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Any such changes made will be reported to the Council at its next meeting following the change.
- 8.4 The Capital Programme agreed at Council on 27th January does not identify any new borrowing requirements for capital purposes during 2004/05, but includes £1.8m in respect of Park Sports Centre in 2005/06.
- 8.5 The Prudential Code requires the Council to set upper and lower limits for the maturity structure of its borrowings. The borrowing in respect of Park Sports Centre is likely to be for 10 years and above.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate		
	Upper Limit	Lower Limit
Under 12 months	10%	0
12 months and within 24 months	10%	0
24 months and within 5 year	50%	0
5 years and within 10 years	90%	0
10 years and above	90%	5%

9 DEBT RESCHEDULING

- 9.1 The reasons for rescheduling to take place would be to balance the long term portfolio and to maximise housing subsidies. All rescheduling would be undertaken following advice from our treasury consultants and would be reported to the Policy and Finance Committee at the meeting following the action.

10 TEMPORARY INVESTMENTS STRATEGY

- 10.1 This authority maintains only temporary, short term investments and investments will accordingly be made with reference to the cash flow requirements. All investment is undertaken within the Council's Treasury Management Policy and Treasury Management Practices.
- 10.2 Lending shall only be made to counterparties on the Authorised list. This list has been compiled from advice from the Council's treasury advisers, who have fully researched the background and credit of counterparties using credit ratings of Fitch Ratings and Moody's Investor Services plus balance sheet analysis.
- 10.3 A review of the list is undertaken regularly in the light of updated credit ratings and the advice of our treasury consultants. As a result, a number of amendments are proposed and are indicated in Appendix A. Because the credit rating gives a view as to whether a counterparty is endorsed for long term investments or short term investments, the maximum length of the investment is shown as well as the total sum invested.
- 10.4 Our policy is to lend to those who, at the date of the loan, are on the authorised list and who offer the most competitive rate of interest. Alternatively the funds are deposited in one of the Authority's Reserve accounts. The Council also invests small balances with the Co-Operative Bank and has arrangements for Business Reserve Accounts with Abbey National and Bank of Scotland.
- 10.5 It is recommended that the Council sets both an upper limit on its fixed interest rate exposure for 2004/05 to 2006/07 of 75% of its investments and also an upper limit on its variable rate exposure for 2004/05 to 2006/07 of 80%. This is a continuation of current practice and reflects the high use of the reserve accounts which have often offered higher rates than the money markets.

11 RISK IMPLICATIONS**11.1 Resource Risk**

Investment income is a material source of income to the Authority. The amount of income generated is dependent upon interest rates and there is always a risk of falling rates.

11.2 Operational Risk

The Treasury management function cannot take place if the treasury strategy is not agreed before the start of the new financial year

12 RESOURCE IMPLICATIONS

12.1 All interest paid and received is accounted for within the General Fund. Charges to the Housing Revenue Account are made in accordance with Government Regulations.

13 RECOMMENDATION

12.1 It is proposed that the Committee **RESOLVES**

- (1) To agree the Treasury Management Strategy for 2004/05 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 Financial Services, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities.
- (3) To note the Prudential Indicators.

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Background Papers:

None

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APPROVED LENDING LIST

	Individual Limit £ M	Limit of Total Holding £ M	days
Abbey National PLC	4	4	364
Abbey National Treasury Services PLC	4		
Royal Bank of Scotland	6	6 *	364
National Westminster	6		
Ulster Bank	3		
Barclays	6	6	364
Lloyds/TSB	6	6 *	364
Cheltenham & Gloucester	3		
HSBC		6	364
Bank of Scotland	6	6	364
Halifax	6		
Alliance & Leicester		4	364
Nationwide		4	364
Bradford & Bingley		3	90
Clydesdale Bank		3	90
Northern Rock PLC		3	90
Other Local Authorities		6	364
<u>Changes to Limits</u>			
The Co-Operative Bank Plc		3	90
Bristol & West		4	364
<u>Added</u>			
Britannia Building Society		3	90
Yorkshire Building Society		3	90
Principality Building Society		3	90
Coventry Building Society		3	90
Skipton Building Society		3	90

* The individual limit at the shorter investment period must not be exceeded.