WYRE FOREST DISTRICT COUNCIL

CABINET
21st FEBRUARY 2008

THE PRUDENTIAL SYSTEM OF LOCAL GOVERNMENT FINANCE AND THE TREASURY MANAGEMENT POLICY AND STRATEGY REPORT 2008/2009

AN OPEN ITEM	
COMMUNITY STRATEGY THEME:	-
CORPORATE PLAN THEME:	Improving Corporacy & Performance
KEY PRIORITY:	Financial & Asset Management
STRATEGY:	Budget & Policy Framework
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APPENDIX 1 **APPENDIX 2** **APPENDIX 3** **APPENDIX 4** **APPENDIX 5** **APPENDIX 6**	Prudential Indicators Treasury Management Policy Statement Treasury Management Practices (TMP) Treasury Management Practices - Detailed Responsibilities, Compliances and Limitations Investment Strategy Approved Organisations for Investments

1. PURPOSE OF REPORT

1.1 To provide Members with background information on the Chartered Institute of Public Finance (CIPFA) Prudential Code for Capital Finance in Local Authorities (Prudential Code), and to seek approval for the Prudential Indicators and Limits for the financial years 2008/2009 to 2010/2011.

1.2 To seek approval for the Council's Treasury Management and Investment Policy and Strategy for the financial year 2008/2009.

1.3 To fulfil the three key reports required by the Local Government Act 2003:

- The reporting of the Prudential Indicators as required by the CIPFA Prudential Code;
- The Treasury Management Strategy in accordance with the CIPFA Code of Practice on Treasury Management;
- The Investment Policy and Strategy (in accordance with Communities and Local Government (CLG) investment guidance).

2. RECOMMENDATIONS

The Cabinet RECOMMENDS to Council to:

2.1 Adopt the updated Prudential Indicators and Limits for 2008/2009 to 2010/2011.

2.2 Approve the updated Treasury Management and Investment Policy and Strategy 2008/2009 and associated Prudential Indicators.

2.3 Approve the Minimum Revenue Provision (MRP) Statement that sets out the Council's policy on MRP.

2.4 Revisit, as part of Budget Monitoring, the Prudential Indicators following the approval of the Council's Budget Strategy as the indicators included within this report are based on current recommendations.

3. EXECUTIVE SUMMARY

3.1 **Capital Expenditure** - The projected capital expenditure is expected to be:

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Capital expenditure	5,943	10,126	9,531	6,701

3.2 **Debt Requirement** - Part of the capital expenditure programme will be financed directly (through Government Grants, capital receipts etc.), leaving a residue that will increase the Council's external borrowing requirement (its Capital Financing Requirement – CFR). The General Fund CFR is reduced each year by a statutory revenue charge (if applicable), known as the Minimum Revenue Provision (MRP) and a Voluntary Revenue Provision (VRP) for the repayment of debt. Under current regulations, this Council has calculated it's MRP to be nil, however, for prudence and to maintain a satisfactory CFR, a VRP is charged (see paragraph 4.3.5). Approval of an MRP Statement is required for the first time to cover proposed changes to the calculation of this provision. Based on current practice the new legislation would not impact on this Council as the revenue provision would revert from VRP to MRP.

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Capital Financing Requirement	2,129	2,308	1,960	2,636

3.2.1 Against this borrowing need (the CFR), the Council's expected external debt position for each year (the Operational Boundary), and the maximum amount it could borrow (the Authorised Limit) are:

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Authorised limit	3,500	4,000	4,500	5,000
Operational boundary	500	500	500	500

3.2.2 The impact of the new capital schemes being approved as part of this budgetary cycle on the Council Tax is expected to be:

Incremental impact of capital investment decisions on:	2008/09 Estimated £	2009/10 Estimated £	2010/11 Estimated £
Band D Council Tax	13.70	6.89	12.28

3.3 **Investments** – The resources applied to finance the capital spend above is one of the elements which influence the overall resources of the Council. The expected position of Council's year end resources (balances, capital receipts, etc.), is shown below to provide an overall estimate of the year end investment position. The prudential indicator limiting longer term investments is also shown.

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Total Resources represented by Total Investments	25,000	25,000	20,000	15,000
Maximum principal sums invested for longer than 364 days	20,000	20,000	15,000	10,000

4. THE PRUDENTIAL INDICATORS 2007/2008 TO 2010/2011

4.1 BACKGROUND

4.1.1 The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. This report revises the indicators for 2007/2008, 2008/2009 and 2009/2010, and introduces new indicators for 2010/2011. Each indicator either summarises the expected activity or introduces limits upon the activity, and reflects the outcome of the Council's underlying capital appraisal systems.

4.1.2 Within this overall prudential framework there is a clear impact on the Council's treasury management activity, either through borrowing or investment activity. As a consequence the treasury management strategy for 2008/2009 is included in the attached appendices to complement the indicators, and this report includes the prudential indicators relating to the treasury activity.

4.2 CAPITAL EXPENDITURE

4.2.1 The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This expenditure can be funded (by resources such as capital receipts, capital grants, borrowing, direct revenue financing etc.), but if resources are insufficient any residual expenditure will form a borrowing need.

4.2.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and will need to be paid for from the Council's own resources. The Government retains an option to control either the total of all Councils' plans, or those of a specific council, although no control has yet been required.

4.2.3 The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale.

4.2.4 The Council is asked to approve the summary capital expenditure projections below. Service details are contained within the Capital Programme Report in the Financial Strategy 2008/2011 booklet, adjusted for slippage identified in the Quarter 3 Budget Monitoring Cabinet Report. This forms the first prudential indicator:

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Capital Expenditure	5,943	10,126	9,531	6,701
Financed by:				
Capital receipts	3,229	7,847	3,224	4,813
Future Capital Receipts	0	0	5,936	400
Capital grants	1,588	1,111	200	200
Revenue	135	525	0	0
Net financing need for the year	**991**	**643**	**171**	**1,288**

4.3 THE CAPITAL FINANCING REQUIREMENT (the Council's Borrowing Need)

4.3.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.

4.3.2 The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision). The Council also undertakes additional voluntary payments within the regulations.

4.3.3 Draft CLG Regulations are currently issued for comment which, if implemented, will require full Council to approve **an MRP Statement**. This will need to be approved in advance of each year. Whilst the regulations will revoke current MRP requirements, Councils are allowed to continue historical accounting practice. A variety of options are provided to Councils to replace the existing Regulations, so long as there is a prudent provision. The timetable for implementation is very tight and so Members are asked to approve the following policy, based on the draft Regulations. Should the final regulations change this Statement, it will be re-submitted for approval. As stated above, the Council has currently calculated its MRP to be nil. However, it is still necessary to have Council approval of the MRP Statement.

4.3.4 The Council is recommended to approve the following MRP Statement:

- For capital expenditure incurred before 1 April 2008 or which in the future will Supported Capital Expenditure, the MRP policy will be:

  Existing practice - MRP will follow the existing practice outline in former CLG Regulations

- From 1 April 2008 for all unsupported borrowing the MRP policy will be:

  Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Directive)

This is the method currently used for calculating the Voluntary Revenue Provision.

4.3.5 The Council is asked to approve the CFR projections below:

Capital Financing Requirement £'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Total CFR	2,129	2,308	1,960	2,636
Movement in CFR	644	179	(348)	676

Movement in CFR represented by				
Net financing need for the year (above)	991	643	171	1,288
VRP and other financing movements	(347)	(464)	(519)	(612)
Total movement in CFR	**644**	**179**	**(348)**	**676**

4.4 LIMITS TO BORROWING ACTIVITY

4.4.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

4.4.2 For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2008/2009 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Gross Borrowing	42	40	38	36
Investments	(25,000)	(25,000)	(20,000)	(15,000)
Net Investment position	(24,958)	(24,960)	(19,962)	(14,964)
CFR	2,129	2,308	1,960	2,636

4.4.3 The Head of Financial Services reports that the Council complied with the prudential indicator detailed in 4.4.2 in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the base Financial Strategy 2008/2011.

4.4.4 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- **The Authorised Limit for External Debt** – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.
- **The Operational Boundary for External Debt** –This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.

4.4.5 The Council is asked to approve the following Authorised Limits and Operational Boundaries:

Authorised Limit £'000	**2007/08 Revised**	**2008/09 Estimated**	**2009/10 Estimated**	**2010/11 Estimated**
Borrowing	3,500	4,000	4,500	5,000
Other long term liabilities	0	0	0	0
Total	3,500	4,000	4,500	5,000
Operational Boundary £'000	**2007/08 Revised**	**2008/09 Estimated**	**2009/10 Estimated**	**2010/11 Estimated**
Borrowing	500	500	500	500
Other long term liabilities	0	0	0	0
Total	500	500	500	500

4.5 AFFORDABILITY PRUDENTIAL INDICATORS

4.5.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

4.5.2 **Actual and Estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	**2007/08 Revised**	**2008/09 Estimated**	**2009/10 Estimated**	**2010/11 Estimated**
Ratio	(7.85)	(6.16)	(5.97)	(5.19)

4.5.3 The estimates of financing costs include current commitments and the proposals in the base Financial Strategy 2008/2011.

4.5.4 **Estimates of the incremental impact of capital investment decisions on the Council Tax** – This indicator identifies the revenue costs associated with ***new schemes*** introduced to the three year capital programme recommended in the base Financial Strategy 2008/2011 compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support, which are not published over a three year period.

4.5.5 **Incremental impact of capital investment decisions on the Band D Council Tax**

£	Proposed Budget 2008/09	Forward Projection 2009/10	Forward Projection 2010/11
Council Tax - Band D	13.70	6.89	12.28

5. TREASURY MANAGEMENT STRATEGY 2008/2009 TO 2010/2011

5.1 BACKGROUND

5.1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets the balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy that require approval.

5.1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 27th February 2003 C90 (10), and as a result adopted a Treasury Management Policy Statement (Executive 13th February 2003 ED.223). This adoption meets the requirements of the first of the treasury prudential indicators. Appendix 2 sets out the Treasury Management Policy Statement.

5.1.3 An annual strategy is reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year.

5.1.4 This strategy covers:

- The Council's debt and investment projections;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities;
- Any local treasury issues.

5.2 DEBT AND INVESTMENT PROJECTIONS 2008/2009 TO 2010/2011

5.2.1 The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances.

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
External Debt				
Debt at 31 March	42	40	38	36
Investments				
Total Investments at 31 March	(25,000)	(25,000)	(20,000)	(15,000)

.5.2.2 The related impact of the above movements on the revenue budget are:

£'000	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Revenue Budgets				
Interest on Borrowing	3	3	3	3
Investment income	(1,700)	(1,600)	(1,500)	(1,400)

5.3 EXPECTED MOVEMENT IN INTEREST RATES

5.3.1 The current position of the treasury function, and its expected change in the future, introduces risk to the Council from an adverse movement in interest rates. The Prudential Code is constructed on the basis of affordability, part of which is related to borrowing costs and investment returns. The Council employs Butlers, the treasury consultants, to advise on the treasury strategy, to provide economic data and interest rate forecasts, to assist planning and reduce the impact of unforeseen adverse movements.

5.3.2 The Base Rate increased during the year 2007/2008 from 5.25% to 5.75%, reducing to 5.25% in December 2007. Analysts confirm that there is uncertainty over the future changes in Base Rate for 2008/2009 and the longer term.

5.3.3 The expected movement in interest rates are as follows:

Medium-Term Rate Forecasts (averages)

	Bank Rate	1-year LIBOR*	5-year Gilt	20-yr Gilt	50-yr Gilt
2006/07	4.8	5.3	4.9	4.4	4.0
2007/08	5.6	6.0	5.3	4.9	4.5
2008/09	4.8	4.7	4.7	4.8	4.6
2009/10	4.8	4.8	4.8	4.7	4.6
2010/11	5.0	5.3	4.9	4.8	4.8
2011/12	5.2	5.5	5.3	5.2	5.1

*London Interbank Offered Rate

5.3.4 **Short Term Interest Rates** - While the December cut in Bank Rate ultimately came as no great surprise to the financial markets it did reflect the Monetary Policy Committee's (MPC) growing unease about the state of the domestic economy.

5.3.5 The November Inflation Report did highlight the threat of a comparatively steep decline in economic activity in 2008. However, until then there had been few decisive signals that this process had commenced in earnest. More recently, the economic data has been transmitting an increasing amount of evidence that this may indeed be the case.

5.3.6 The cooling in the housing market has been noted for some time although it is only in the past few months that the two key indicators on this front (the Nationwide & Halifax Indices) have moved down in unison. The deciding factors behind the MPC's decision were probably the Chartered Institute of Purchasing and Supply's (CIPS) November surveys of the manufacturing and service sectors.

5.3.7 Both these indicators pointed towards a marked deceleration in activity on a broad front and may well have been interpreted by the policy doves as a sure sign that the effects of the summer's credit squeeze are beginning to spread beyond the confines of the financial markets.

5.3.8 The squeeze on credit represents a sharp and involuntary tightening of domestic monetary policy. The fact that it is likely to take some time to evaporate suggests that consumers' expenditure (which has still to see the full effects of the adjustment of discounted, fixed-rate mortgages) will eventually respond through a marked contraction.

5.3.9 This, along with an easing of capacity constraints as the economy slows down, is expected to reduce inflation pressures and ensure Consumer Prices Index (CPI) growth reverts to the 2% central target rate over the medium term.

5.3.10 Nevertheless, the Bank of England does note that the upside risks to inflation remain. Many of the current pressures are externally generated (oil, food, commodity prices etc) and will not respond to UK interest rate policy.

5.3.11 Hopes rest upon the anticipated deceleration in international activity reversing at least some of these trends. In the mean time, the MPC is hoping that domestic inflation expectations do not deteriorate and that weakening household consumption prevents companies passing cost increases on to the retail level. The outcome of this “central case” scenario will not be known for some time.

5.3.12 **Longer Term Interest Rates** - Bond markets (which underpin the Council borrowing rates) will remain aware of the risks policy makers are taking with inflation for the sake of engineering a gradual and moderate dip in economic activity. Concerns about the health of the financial sector will persist for some time and these will maintain the downward bias to bond yields in the near term.

5.3.13 However, investors may be unsettled by the risks central banks are taking with long-term inflation control in their attempts to shore up faltering activity. Worries about inflation prospects in the medium to long term are expected to drive yields higher through 2008/09 and beyond.

5.4 BORROWING STRATEGY 2008/2009 TO 2010/2011

5.4.1 The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

5.4.2 The risks associated with long-term fixed interest rates are expected to be for higher rates over the medium term. The Head of Financial Services, under delegated powers, will take the most appropriate form of borrowing, if required.

5.4.3 A key change in the options for borrowing and rescheduling occurred on 1 November 2007 when the Public Works Loan Board (PWLB) changed its interest rate structure to a more sensitive pricing method and also increased the relative cost of repaying debt. This will prompt a more cautionary approach to borrowing.

5.4.4 **Sensitivity to Interest Rate Movements**

Future Council accounts will be required to disclose the impact of risks on the Council’s treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

£'000	2008/09 Estimated + 1%	2008/09 Estimated - 1%
Revenue Budgets		
Interest on Borrowing	0	0
Investment income (increase)/decrease	(160)	160

5.4.5 The 2008/2009 Capital Programme is to be funded mainly from the Council's capital receipts and government grants. However, following a detailed analysis by the Head of Financial Services, under delegated powers, the Council now funds the Vehicle, Equipment and Systems Renewals with a combination of direct revenue financing and medium term borrowing. Several other schemes are also to be funded by direct revenue financing.

5.4.6 Taking the above factors into account, and having regard to the Treasury Management Prudential Indicators and Limits on Activity, the strategy for borrowing is:

1. To fund the capital programme requirements from the Council's own capital receipts, grants, direct revenue funding and borrowing as appropriate.

2. The Vehicle, Equipment and Systems Renewals to be funded by means of medium term borrowing and direct revenue financing.

3. To fund any overdrawn bank balances by appropriate borrowing.

5.5 INVESTMENT COUNTERPARTY AND LIQUIDITY FRAMEWORK

5.5.1 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

5.5.2 The Head of Financial Services will maintain a counterparty list in compliance with the criteria specified in Appendix 6 and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it selects which counterparties the Council will choose rather than defining what its investments are. The rating criteria uses the lowest common denominator method of selecting counterparties and applying limits.

5.5.3 The proposed criteria for Specified and Non-Specified investments are shown in Annex B1 to Appendix 6 for approval.

5.5.4 In the normal course of the Council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

5.5.5 The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the investment prudential indicator detailed in 5.7.2.

5.6 INVESTMENT STRATEGY 2008/2009 TO 2010/2011

5.6.1 The Council's Investment Strategy shall comply with Guidance issued by the ODPM and shall have regard to the Code of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) on Treasury Management in the Public Services: Code of Practice and Cross-Sectional Guidance Notes. The Investment Strategy is set out in Appendix 5.

5.6.2 Priority should be given to security and liquidity, whilst seeking to achieve the highest rate of return on the Council Investments consistent with the proper levels of security and liquidity.

5.6.3 The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and Adviser's own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise, subject to over riding credit counterparty security. The Head of Financial Services, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

5.6.4 Direct investments be made with only those Organisations identified in the 'Approved Organisations for Investments' - see Appendix 6.

5.6.5 Individual investment limits to be those identified in Appendix 6.

5.6.6 Minimum credit ratings for individual Organisations should be adhered to and be those identified in Appendix 6. Credit Ratings to be monitored on an ongoing basis with information provided by the Council's Treasury Management Consultants 'Butlers'. In respect of Building Societies, the Council will continue to use Total Assets since 'credit ratings' are not always available.

5.6.7 Whilst taking into account the overriding principle (see 5.6.2) the Strategy for investments is to lend funds which are surplus (after cash flow requirements have been taken into account) on a longer term basis where interest rates are projected to fall or show little upwards movements. Alternatively, should interest rates be forecast to move noticeably upwards, to lend surplus funds on a shorter term basis, unless materially higher long term interest rates can be obtained, when surplus funds should be lent on a longer term basis.

5.6.8 The use of specialist investment managers be considered by the Head of Financial Services on an ongoing basis, to manage a proportion of the Council's Investments (minimum market requirement usually £10 million) where market conditions are considered favourable to achieve higher overall investment returns. Specialist investment managers will be appointed by the Head of Financial Services under delegated powers and subject to the Council's Standing Orders Relating to Contracts, if applicable.

5.6.9 No more than maximum sums to be invested (see 5.7.2) of the Council's Investments shall be made as Non-Specified Investments, which are now classified as :-

- Investments in excess of one year

- Small Building Societies without Credit Rating (note the Council's individual limit detailed in Appendix 6)

5.6.10 Taking the above factors into account, and having regard to the Treasury Management Prudential Indicators and Limits on Activity, the strategy for investments is:

1. To lend funds which are surplus (after cash flow requirements have been taken into account) on a longer term basis where short term interest rates are projected to fall or show little upwards movement.

2. Should investment requirements exceed £10million and market conditions are likely to be favourable, to appoint suitable Investment Managers at the appropriate time in accordance with the Council's Standing Orders Relating to Contracts.

3. Alternatively, should short term interest rates be forecast to move noticeably upwards, to lend surplus funds on a shorter term basis, unless materially higher long term interest rates can be obtained, when surplus funds should be lent on a longer term basis.

5.7 TREASURY MANAGEMENT PRUDENTIAL INDICATORS AND LIMITS ON ACTIVITY

5.7.1 There are four further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are:

- Upper limits on variable interest rate exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
- Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- Total principal funds invested for greater than 364 days – These limits are set to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

5.7.2 The Council is asked to approve the following prudential indicators:

<table>
<tr><th></th><th colspan="2">2008/09</th><th colspan="2">2009/10</th><th>2010/11</th></tr>
<tr><td colspan="6">Interest rate Exposures</td></tr>
<tr><td></td><td colspan="2">Upper</td><td colspan="2">Upper</td><td>Upper</td></tr>
<tr><td>Limits on fixed interest rates based on net debt</td><td colspan="2">100%</td><td colspan="2">100%</td><td>100%</td></tr>
<tr><td>Limits on variable interest rates based on net debt</td><td colspan="2">22%</td><td colspan="2">22%</td><td>22%</td></tr>
<tr><td colspan="6">Maturity Structure of fixed interest rate borrowing 2008/09</td></tr>
<tr><td colspan="2"></td><td colspan="2">Lower</td><td colspan="2">Upper</td></tr>
<tr><td colspan="2">Under 12 months</td><td colspan="2">0%</td><td colspan="2">100%</td></tr>
<tr><td colspan="2">12 months to 2 years</td><td colspan="2">0%</td><td colspan="2">100%</td></tr>
<tr><td colspan="2">2 years to 5 years</td><td colspan="2">0%</td><td colspan="2">100%</td></tr>
<tr><td colspan="2">5 years to 10 years</td><td colspan="2">0%</td><td colspan="2">100%</td></tr>
<tr><td colspan="2">10 years and above</td><td colspan="2">0%</td><td colspan="2">100%</td></tr>
<tr><td colspan="6">Maximum principal sums invested > 364 days</td></tr>
<tr><td>Principal sums invested > 364 days</td><td colspan="2">£20m</td><td colspan="2">£15m</td><td>£10m</td></tr>
</table>

5.8 PERFORMANCE INDICATORS

5.8.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. An example of the performance indicator often used for the treasury function is:

- Investments – Internal returns above the 7 day London Interbank Bid Rate (LIBID) rate

The result of this indicator will be reported in the Treasury Management Annual Report for 2007/08.

6. KEY ISSUES

Key Issues are contained within sections 4 and 5 of this report.

7. FINANCIAL IMPLICATIONS

7.1 The Financial Implications of the Treasury management function are included in the Council's medium term financial strategy and Three Year Budget and Policy Framework.

8. LEGAL AND POLICY IMPLICATIONS

8.1 The Local Government Act 2003 supplemented by Regulations set out a new framework for a prudential system for local authority capital finance. This Act, together with CIPFA's Prudential Code for Capital Finance in Local Authorities, came into effect on 1st April 2004. This code guides decisions on what Local Authorities can afford to borrow and has statutory backing under Regulations issued in accordance with the Local Government Act 2003.

8.2 Adoption of the CIPFA Code of Practice on Treasury Management in the Public Services as part of the Authority's Standing Orders and Financial Regulations, gives it the status of a "code of practice made or approved by or under any enactment", and hence proper practice under the provisions of the Local Government and Housing Act 1989.

9. RISK MANAGEMENT

9.1 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisors, has proactively managed the portfolio over the year.

9.2 Shorter-term variable rates and likely future movement in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the lending list, accurately forecasting returns can be difficult.

10. CONCLUSION

See Recommendations.

11. CONSULTEES

Butlers Financial Advisors
Leader of the Council
CMT

12. BACKGROUND PAPERS

12.1 Local Government Act 2003
12.2 CIPFA's Prudential Code for Capital Finance in Local Authorities
12.3 CIPFA's Code of Practice on Treasury Management in the Public Services
12.4 Local Government and Housing Act 1989
12.5 Cabinet Report 27/09/2007 – Report on Treasury Management Service and Actual Prudential Indicators 2006/2007