

**WYRE FOREST DISTRICT COUNCIL**

**CABINET**  
**19th FEBRUARY 2009**

**THE PRUDENTIAL SYSTEM OF LOCAL GOVERNMENT**  
**FINANCE AND THE TREASURY MANAGEMENT**  
**POLICY AND STRATEGY REPORT 2009/2010**

<b>AN OPEN ITEM</b>	
<b>COMMUNITY STRATEGY THEME:</b>	-
<b>CORPORATE PLAN THEME:</b>	Improving Corporacy & Performance
<b>KEY PRIORITY:</b>	Financial & Asset Management
<b>STRATEGY:</b>	Budget & Policy Framework
<b>CABINET MEMBER:</b>	Councillor John Campion
<b>RESPONSIBLE OFFICER:</b>	Head of Financial Services
<b>CONTACT OFFICERS:</b>	D Buckland Ext. 2100 S. Edmonds Ext. 2123 T. Southall Ext. 2125 <a href="mailto:stuart.edmonds@wyreforestdc.gov.uk">stuart.edmonds@wyreforestdc.gov.uk</a> <a href="mailto:tracey.southall@wyreforestdc.gov.uk">tracey.southall@wyreforestdc.gov.uk</a>
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**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).
- 1.2 To seek approval for the Prudential Indicators and Limits for the financial years 2009/2010 to 2011/2012 and set out the expected treasury operations for this period.
- 1.3 To seek approval for the Council's Treasury Management Strategy for the financial year 2009/2010 which sets out how the Council's treasury service will support the capital decisions taken, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003 and is in accordance with the CIPFA Code of Practice on Treasury Management.

- 1.4 To seek approval for the Council's Investment Policy and Strategy for the financial year 2009/2010 which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG Investment Guidance. This proposed strategy also incorporates the draft report from the Treasury Management Review panel established following the collapse of the banks with Icelandic connections.
- 1.5 To fulfil four key legislative requirements:
- 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);
  - The Minimum Revenue Provision (MRP) Policy (as required by Regulation under the Local Government and Public Involvement in Health Act 2007).

## **2. RECOMMENDATIONS**

**The Cabinet RECOMMENDS to Council to:**

- 2.1 **Adopt the updated Prudential Indicators and Limits for 2009/2010 to 2011/2012.**
- 2.2 **Approve the updated Treasury Management and Investment Policy and Strategy 2009/2010, the associated Prudential Indicators and the detailed criteria included in Appendix 6.**
- 2.3 **Approve the Minimum Revenue Provision (MRP) Statement that sets out the Council's policy on MRP.**
- 2.4 **Approve the Authorised Limit Prudential Indicator.**
- 2.5 **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.**
- 2.6 **Carry out a full review of the current Treasury Management Practices (TMP) with the assistance of the Council's Treasury Consultants.**

## **3. EXECUTIVE SUMMARY**

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

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<b>£'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Capital expenditure	7,624	11,126	11,584	8,765

- 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 the statutory revenue charge for the repayment of debt, known as the Minimum Revenue Provision (MRP).

<b>£'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Capital Financing Requirement	1,927	3,226	4,280	8,822

- 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:

<b>£'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Authorised limit	4,000	5,000	6,000	9,000
Operational boundary	800	800	800	1,000

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

<b>Incremental impact of capital investment decisions on:</b>	<b>2009/10 Estimated £</b>	<b>2010/11 Estimated £</b>	<b>2011/12 Estimated £</b>
Band D Council Tax	3.69	7.84	11.05

- 3.3 **Investments** – The resources applied to finance capital expenditure 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, which is designed to reduce the Council's risk to adverse cash flow risk and counter-party risk.

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<b>£'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Total Resources represented by Total Investments	20,000	15,000	12,000	9,000
Maximum principal sums invested for longer than 364 days	15,000	10,000	7,000	4,000

**4. THE PRUDENTIAL INDICATORS 2008/2009 TO 2011/2012****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 2008/2009, 2009/2010 and 2010/2011, and introduces new indicators for 2011/2012. 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 2009/2010 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. This needs to be affordable, sustainable and prudent. The revenue consequences of unsupported expenditure 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. Anticipated asset sales may be postponed to allow for a recovery in the property market so as to maximise sale value.

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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 2009/2012 booklet, adjusted for slippage identified in the Quarter 3 Budget Monitoring Cabinet Report. This forms the first prudential indicator:

£'000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
<b>Capital Expenditure</b>	7,624	11,126	11,584	8,765
<b>Financed by:</b>				
Capital receipts	5,298	7,713	3,119	2,463
Future Capital Receipts	0	103	5,870	0
Capital grants	1,651	795	798	798
Revenue	249	682	0	0
<b>Net financing need for the year</b>	<b>426</b>	<b>1,833</b>	<b>1,797</b>	<b>5,504</b>

### 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.

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).

CLG Regulations have been issued which require full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils to replace the existing Regulations, so long as there is a prudent provision. 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)

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

<b>Capital Financing Requirement £'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
<b>Total CFR</b>	1,927	3,226	4,280	8,822
<b>Movement in CFR</b>	27	1,299	1,054	4,542

<b>Movement in CFR represented by</b>				
Net financing need for the year (above)	426	1,833	1,797	5,504
MRP and other financing movements	(399)	(534)	(743)	(962)
<b>Total movement in CFR</b>	<b>27</b>	<b>1,299</b>	<b>1,054</b>	<b>4,542</b>

#### **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 2009/2010 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

<b>£'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Gross Borrowing	39	37	35	33
Investments	(11,000)	(6,000)	(3,000)	0
Icelandic Investments (currently 'frozen') *	(9,000)	(9,000)	(9,000)	(9,000)
Net Investment position	(19,961)	(14,963)	(11,965)	(8,967)
CFR	1,924	3,226	4,280	8,822

\* The Financial Strategy does anticipate the return of the Council's investments during within the Medium Term. This will be re-invested as appropriate taking into account the approved investment limits.

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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 is projected to comply with this indicator for the future three years. This view takes into account current commitments, existing plans, and the proposals in the base Financial Strategy 2009/2012. It should be noted that from 2011/12 onwards there will be a requirement to undertake external borrowing to fund the housing capital programme as the expenditure is incurred. As a consequence, there is a higher level of CFR shown in 2011/12. However, this borrowing requirement has not yet been factored into the Operational Boundary expectations as the exact timing of the external borrowing is unsure.

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 control on the overall level of borrowing and a limit beyond which external debt is prohibited. The 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 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 exercised.
- **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:

<b>Authorised Limit £'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Borrowing	4,000	5,000	6,000	9,000
Other long term liabilities	0	0	0	0
Total	4,000	5,000	6,000	9,000
<b>Operational Boundary £'000</b>	<b>2008/09 Revised</b>	<b>2009/10 Estimated</b>	<b>2010/11 Estimated</b>	<b>2011/12 Estimated</b>
Borrowing	800	800	800	1,000
Other long term liabilities	0	0	0	0
Total	800	800	800	1,000

## 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.

%	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
Ratio	(6.21)	1.38	1.51	2.64

- 4.5.3 The estimates of financing costs include current commitments and the proposals in the base Financial Strategy 2009/2012.

- 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 2009/2012 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 2009/10	Forward Projection 2010/11	Forward Projection 2011/12
Council Tax - Band D	3.69	7.84	11.05

## 5. TREASURY MANAGEMENT STRATEGY 2009/2010 TO 2011/2012

### 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 27<sup>th</sup> February 2003 C90 (10), and as a result adopted a Treasury Management Policy Statement (Executive 13<sup>th</sup> 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 During the last six months there has been significant attention in this area following the collapse of banks with which the Council has a total of £9m invested. Following the collapse of these banks the Council has undertaken a thorough Treasury Management Review process and the findings of this review are due to be presented to the Cabinet on 19 February 2009. This proposed Treasury Management Strategy incorporates the findings and recommendations from this Review Panel.

5.1.5 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 2009/2010 TO 2011/2012**

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	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
<b>External Debt</b>				
Debt at 31 March	39	37	35	33
<b>Investments</b>				
Investments at 31 March	(11,000)	(6,000)	(3,000)	0
Icelandic Investments at 31 March (currently 'frozen') *	(9,000)	(9,000)	(9,000)	(9,000)
Total Investments at 31 March	(20,000)	(15,000)	(12,000)	(9,000)

\* The Financial Strategy does anticipate the return of the Council's investments during within the Medium Term. This will be re-invested as appropriate taking into account the approved investment limits.

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

£'000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
<b>Revenue Budgets</b>				
Interest on Borrowing	3	2	2	2
Investment income	(1,389)	(309)	(560)	(554)

### 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 UK economy has entered a profound recession, worsened by a dangerous combination of negative growth and dislocation in the domestic and world financial markets. The situation in the economy is considered critical by the policy setters who are concerned that the testing financial environment, the sharp decline in house prices and persistently tight credit conditions could trigger a collapse in consumer confidence. At worst this could deliver a prolonged Japanese-style recession.

5.3.3 The expected movement in interest rates are as follows:

**Interest Rate Forecasts – 2007/2010**

Year	End Period	Money Rates				PWLB Rates*		
		Bank Rate	3mth	6mth	12mth	5 yr	20 yr	50 yr
2007	Dec	5.50	6.0	5.9	5.6	4.6	4.6	4.4
2008	Mar	5.25	6.0	6.0	5.8	4.1	4.7	4.4
	Jun	5.00	6.0	6.2	6.5	5.3	5.1	4.6
	Sep	5.00	6.3	6.4	6.5	4.4	4.8	4.6
	Dec	2.00	3.0	3.2	3.3	3.0	4.2	4.0
2009	Feb	1.00	2.0	2.3	2.4	2.8	4.4	4.3
	Mar	1.00	2.0	2.2	2.4	2.6	4.5	4.4
	Jun	0.50/0.75	1.5	1.6	1.8	2.4	4.7	4.6
	Sep	0.50/0.75	1.5	1.6	1.7	2.4	4.9	4.8
	Dec	1.00	1.6	1.7	1.8	2.5	4.9	4.8
2010	Mar	1.25	1.7	1.9	2.0	2.6	4.9	4.8

**Medium-Term Rate Estimates (averages)**

Annual Average %	Bank Rate	Money Rates		PWLB Rates*		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	1.0	1.6	1.8	2.4	4.8	4.7
2010/11	1.7	2.1	2.8	3.2	4.9	4.8
2011/12	2.4	2.8	3.6	4.0	5.1	4.9

\* Borrowing Rates

- 5.3.4 The Base Rate at the beginning of the financial year was 5.25%, falling to 5% on 10<sup>th</sup> April 2008. It remained constant until the global financial crisis began to take effect in October 2008 commencing with the collapse of various banking institutions across the world. The Monetary Policy Committee (MPC) decreased the rate each month from October 2008, reaching an unprecedented level of 1% on 5<sup>th</sup> February 2009.
- 5.3.5 The sharp downturn in world commodity, food and oil prices, the lack of domestic wage pressures and weak retail demand promises a very steep decline in inflation in the year ahead. In the recent pre-Budget Report, the Treasury suggested RPI inflation could fall to minus 2.25% by September 2009. Inflation considerations will not be a constraint upon Bank of England policy action. Indeed, the threat of deflation strengthens the case for more aggressive policy.
- 5.3.6 The Government's November pre-Budget Report did feature some fiscal relaxation but it also highlighted the very poor health of public sector finances. The size of the package is considered insufficient to kick-start the economy. The onus for economic stimulation will fall upon monetary policy and the Bank of England.

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- 5.3.7 The Bank will continue to ease policy and the need to drive commercial interest rates, currently underpinned by the illiquidity of the money market, to much lower levels suggests the approach will be more aggressive than might otherwise have been the case. A Bank Rate below 1% now seems a distinct possibility and short-term LIBOR rates of below 2% may result. Only when the markets return to some semblance of normality will official rates be edged higher.
- 5.3.8 Long-term interest rates will be the victim of conflicting forces. The threat of deep global recession ought to drive bond yields to yet lower levels. However, much of this is already discounted. The prospect of exceptionally heavy gilt-edged issuance in the next three years (totalling in excess of £100bn per annum), as the Government seeks to finance its enormous deficit, together with concerns about UK inflation further into the future will maintain upward pressure on yields, in spite of the fact that negative RPI inflation in 2009 will raise the level of real yields significantly this year.
- 5.3.9 Within the Financial Strategy approved by the Cabinet for consultation on 22 January 2009, the assumptions in relation to estimated returns for the Council were highlighted, within paragraph 4.5.

## **5.4 BORROWING STRATEGY 2009/2010 TO 2011/2012**

- 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. It is not anticipated that the Council will undertake external borrowing until 2011/12.
- 5.4.2 However, long-term fixed interest rates are at risk of being higher over the medium term. The Head of Financial Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide better opportunities.
- 5.4.3 With the likelihood of a steepening of the yield curve debt restructuring is likely focus on switching from longer term fixed rates to cheaper shorter term debt, although the Head of Financial Services and treasury consultants will monitor prevailing rates for any opportunities during the year.
- 5.4.4 The option of postponing borrowing and running down investment balances could also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

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5.4.5 The 2009/2010 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 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. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria.

- 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 2009/2010 TO 2011/2012**

- 5.6.1 The Council's Investment Strategy shall comply with Guidance issued by the CLG 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 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current low Bank Rate continuing throughout 2009. 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.
- 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 only use those with Total Assets in excess of £10bn since 'credit ratings' are not always available.

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- 5.6.7 There is a clear operational difficulty arising from the current banking crisis. Ideally investments would be invested longer to secure better returns, however uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.
- 5.6.8 **The criteria for choosing counterparties set out above provide a sound approach to investment in “normal” market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Head of Financial Services will restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to “normal” conditions. Similarly the time periods for investments will be restricted.**
- 5.6.9 Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria has been amended to reflect these facilities.
- 5.6.10 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.
- 5.6.11 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 short term basis until the banking system returns to “normal” conditions.
  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.

**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 debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

£'000	2009/10 Estimated + 1%	2009/10 Estimated - 1%
<b>Revenue Budgets</b>		
Interest on Borrowing	0	0
Investment income (increase)/decrease	(110)	110

**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:

	2009/10	2010/11	2011/12
<b>Interest rate Exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	100%	100%	100%
<b>Limits on variable interest rates based on net debt</b>	100%	100%	100%
<b>Maturity Structure of fixed interest rate borrowing 2008/09</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	
<b>Maximum principal sums invested &gt; 364 days</b>			
Principal sums invested > 364 days	£10m	£7m	£4m

## **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 2008/09.

## **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 1<sup>st</sup> 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 23/10/2008 – Report on Treasury Management Service and Actual Prudential Indicators 2007/2008  
12.6 Cabinet Report 18/12/2008 – Treasury Management Update