DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**DSFRA/11/2**
MEETING	**DEVON & SOMERSET FIRE & RESCUE AUTHORITY (BUDGET MEETING)**
DATE OF MEETING	**14 FEBRUARY 2011**
SUBJECT OF REPORT	**TREASURY MANAGEMENT STRATEGY (INCLUDING PRUDENTIAL AND TREASURY INDICATORS REPORT 2011/12 TO 2013/14)**
LEAD OFFICER	**Treasurer**
RECOMMENDATIONS	***(a)*** ***the Treasury Management Strategy and the Annual Investment Strategy as indicated in this report be approved;*** ***(b)*** ***the prudential indicators and limits, as contained as Appendix A to this report, be approved;*** ***(c)*** ***the Minimum Revenue Provision (MRP) statement for 2011/2012, as contained as Appendix B to this report, be approved;*** ***(d)*** ***that the Treasurer be delegated authority to effect movements between the separately agreed prudential limits for borrowing;*** ***(e)*** ***that the statement at paragraph 5.6 of this report that borrowing limits and the debt management strategy have been set to ensure that net borrowing remains below the capital financing requirement for 2011/2012 to 2013/2014, in line with the requirements of the CIPFA Prudential Code, be noted.***
EXECUTIVE SUMMARY	This report sets out a treasury management strategy and investment strategy for 2011/2012, including the Prudential Indicators associated with the capital programme for 2011/2012 to 2013/2014 considered elsewhere on the agenda of this meeting. A Minimum Revenue Provision Statement for 2011/2012 is also included for approval.
RESOURCE IMPLICATIONS	As indicated in this report

EQUALITY IMPACT ASSESSMENT	None
APPENDICES	A. Prudential and Treasury Management Indicators 2011/2012 to 2013/2014. B. Minimum Revenue Provision Statement 2011/2012
LIST OF BACKGROUND PAPERS	Local Government Act 2003. Chartered Institute of Public Finance Accountancy's (CIPFA) Prudential Code. Report to Resources Committee 8 December 2008 – Affordable Capital Investment Plans for 2009/2010 to 2011/2012

1. INTRODUCTION

Background

1.1 Treasury management is defined as:

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

Statutory requirements

1.2 The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to "have regard to" the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

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

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

CIPFA requirements

1.5 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Authority on 19th February 2010.

1.6 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.
- Receipt by the Authority of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a mid-year review report and an annual report (stewardship report) covering activities during the previous year.
- Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Authority of the role of scrutiny of treasury management strategy and polices to a named body. For this Authority the delegated body is Resources Committee.

1.7 In summary, this Authority will adopt the following reporting arrangements in accordance with the requirements of the Code: -

Area of Responsibility	Authority/ Committee/ Officer	Frequency
Treasury Management Policy Statement (revised)	Full authority	Initial adoption in 2010
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full authority	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid-year report	Full authority	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Full authority	
Annual Treasury Outturn Report	Full authority	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Resources Committee	
Treasury Management Practices	Full authority	
Scrutiny of treasury management performance	Resources Committee	

Treasury Management Strategy for 2011/12

1.8 The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury advisor, Sector.

- The strategy covers:
- treasury limits in force which will limit the treasury risk and activities of the Authority
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the MRP strategy

Balanced Budget Requirement

1.9 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Authority 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 Authority for the foreseeable future.

2. TREASURY LIMITS FOR 2011/12 to 2013/14

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

2.2 The Authority 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 Authority council tax levels is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in paragraph 5.7 of this report.

3. CURRENT PORTFOLIO POSITION

3.1 The Authority's treasury portfolio position at 31/12/10 comprised:

TABLE 1		Principal £m	Average Rate %
Fixed Rate Funding	PWLB	29.380	4.24
Variable Rate Funding	PWLB	0	-
Other Long Term liabilities		0	
Gross Debt		29.380	4.24
Total Investments		(13.682)	
Net Debt		15.698	

4. BORROWING REQUIREMENT

4.1 The Authority's borrowing requirement is as follows:

TABLE 2	2009/10 £m	2010/11 £m	2011/12 £m	2012/13 £m	2013/14 £m
External Debt (1 April)	19.281	26.651	28.609	31.154	33.434
New Borrowing	6.700	3.000	2.545	2.280	1.237
Internal Borrowing	0	0	1.542	1.899	0.954
Replacement	1.665	0	0.000	0.000	0.000
Repaid	(0.995)	(1.042)	(1.542)	(1.899)	(0.954)
External Debt (31 March)	26.651	28.609	31.154	33.434	34.671

5. PRUDENTIAL AND TREASURY INDICATORS 2011/12 – 2013/14

5.1 The prudential indicators are relevant for the purposes of setting an integrated treasury management strategy. A summary of the proposed indicators are included as Appendix A to this report. Explanations of the purpose of each of these indicators are provided in the following paragraphs. The Authority is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted on 11 April 2007 by the full authority and the revised Code was adopted by the Authority on 19th February 2010.

Capital Expenditure

5.2 The capital expenditure plans, as proposed in the Capital Programme report considered elsewhere on the agenda, are shown in Table 3.

TABLE 3	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Land and buildings	5.208	3.650	1.750
Vehicles, Plant and Equipment	1.294	1.600	1.900
TOTAL CAPITAL EXPENDITURE	6.502	5.250	3.650

5.3 Additional capital finance sources may become available during the year, for example, additional grants or external contributions. The Authority will be requested to approve increases to the capital programme to be financed from other capital resources as and when the need arises.

Capital Financing Requirement (CFR)

5.4 The Capital Financing Requirement represents the authority's underlying need to borrow for capital purposes. The forecast CFR for 2011/2012 to 2013/2014, based on the spending plans are shown in Table 4.

TABLE 4	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Capital Financing Requirement as at 31 March - borrowing	31.154	33.434	34.671
Capital Financing Requirement as at 31 March – other longterm liabilities	1.885	1.847	1.836
Total Capital Financing Requirement as at 31 March	33.039	35.281	36.507

Limits to Borrowing Activity

5.5 Two Treasury Management Indicators control the level of borrowing. They are:

The *authorised limit* - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the Authority. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2012/13 is revised as part of the 2012/13 budget process. Table 5 below details the recommended Authorised Limits for 2011/2012 and the medium term.

The *operational boundary* – this indicator is based on the probable external debt during the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. Table 6 below details the recommended Operational Boundaries for 2011/2012 and the medium term.

TABLE 5	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Authorised limit for External Debt			
- External Debt	36.229	37.885	39.251
- Other long term liabilities	1.930	1.917	1.856
TOTAL AUTHORISED LIMIT FOR EXTERNAL DEBT	38.159	39.802	41.107

TABLE 6	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Operational Boundary for External Debt			
- External Debt	34.671	36.213	37.517
- Other long term liabilities	1.836	1.825	1.766
TOTAL OPERATIONAL BOUNDARY FOR EXTERNAL DEBT	36.507	38.038	39.283

It is estimated that the actual external debt at 31 March 2011 will be £28.609 million.

Net Borrowing in Comparison to the CFR

5.6 The debt management strategy and borrowing limits for the period 2011/12 to 2013/14 have been set to ensure that over the medium term, net borrowing will only be for capital purposes i.e. net external borrowing does not exceed the total Capital Financing Requirement in the preceding year plus the estimates for the current year and the next two years. This is demonstrated by the fact that the operational boundary for external debt borrowing in 2011/2012 of £36.507 million (Table 6) does not exceed the CFR for 2013/14 of £36.507 million (Table 4).

Prudential Indicators for Affordability

5.7 The previous sections of the report cover the overall limits for capital expenditure and borrowing, but within the overall framework indicators are also included to demonstrate the affordability of capital investment plans.

5.8 A key indicator of the affordability of capital investment plans is the ratio of financing costs to the net revenue stream; this indicator identifies the trend in the cost of capital financing (borrowing costs net of investment income) against the Authority's net budget requirement. Annual capital financing costs are a product of total debt outstanding, the annual repayment regime and interest rates. The forecast ratios for 2011/12 to 2013/14 based on current commitments and the proposed Capital Programme are included in Table 7.

TABLE 7	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
Ratio of Financing Costs to Net Revenue Stream	4.35	4.56	4.93

5.9 At the meeting of Resources Committee, held on the 8 December 2008, the report 'Affordable Capital Investment plans for 2009/2010 to 2011/2012, was considered with a view to determining a level of borrowing for the Authority, which would be deemed to be affordable, sustainable and prudent. In considering this report the Treasurer advised that debt repayments should be kept within a ceiling of 5% of the net revenue stream for the period 2010-11 to 2013-14.

5.10 The estimate of the incremental impact of capital investment decisions proposed in the recommended Capital Programme over and above capital investment decisions that have previously been taken by the Authority are given in Table 8. These figures do not represent the total impact on the Authority tax over and above 2010/2011 as a consequence of the total capital programme, only the incremental impact over and above previous decisions made on capital investment. The figures given represent the incremental impact for a Band D property.

TABLE 8	2011/12 Estimate £ p	2012/13 Estimate £ p	2013/14 Estimate £ p
Element of Authority tax for New Capital Spending	(£0.47)	(£0.39)	(£0.47)

6. PROSPECTS FOR FUTURE INTEREST RATES

6.1 The Authority has appointed Sector Treasury Services as treasury advisor to the Authority and part of their service is to assist the Authority to formulate a view on interest rates. Sectors central view of changes in Bank Rate is shown below;

Sector Bank Rate forecast for financial year ends (March)

2011 0.50%

2012 1.00%

2013 2.25%

2014 3.25%

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

7. BORROWING STRATEGY

Borrowing rates

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

TABLE 9

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	4.30%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	5.10%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%

7.2 In view of the above forecast the Authority's borrowing strategy will be based upon the following information.

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.
- Temporary borrowing from the money markets or other local authorities
- PWLB variable rate loans for up to 10 years.
- Short dated borrowing from non PWLB sources.
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

- PWLB borrowing for periods under ten years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration of longer dated debt.
- Any consideration of further PWLB debt will be in accordance with the authority agreed maturity structure limits, as included in Appendix A.

7.3 Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The authority officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

if it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

7.4 External v. internal borrowing

TABLE 10 – Comparison of gross and net debt positions at year end	2009/10 £m	2010/11 £m	2011/12 £m	2012/13 £m	2013/14 £m
	Actual	Predicted outturn	estimate	estimate	Estimate
Actual external debt (gross)	26.651	28.609	31.154	33.434	34.671
Cash Balances and Investments	(4.355)	(10.000)	(6.000)	(6.000)	(6.000)
Net Debt	22.296	18.609	25.154	27.424	28.671

7.5 This Authority currently has a difference between gross debt and net debt (after deducting cash balances and investments), of £13m. The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Authority obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments. The next financial year is expected to be one with an abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.

7.6 Over the next three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

7.7 However, short term savings by avoiding new long term external borrowing in 2011/12 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher. The Authority has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007, which has been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has potentially meant that large premiums would be incurred by such action; such levels of premiums are unlikely to be justifiable on value for money grounds. This situation will be monitored in case these differentials are narrowed by PWLB at some future date.

7.8 The Authority intends to reduce its call upon PWLB loans by use of internal borrowing equivalent to an average of £1.5m for each of the next three years.

7.9 Against this background caution will be adopted with the 2011/12 treasury operations. The Director of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

Policy on borrowing in advance of need

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

7.11 In determining whether borrowing will be undertaken in advance of need the Authority will;

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

8. DEBT RESCHEDULING

8.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since the 20 October by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have been given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

8.2 As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of premiums incurred, their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the authority's maturity profile as in recent years there has been a skew towards longer dated PWLB.

8.3 Consideration will also be given to identify if there is any potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

8.4 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the adopted borrowing strategy, and
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8.5 All rescheduling will be reported to the Resources Committee, at the earliest meeting following its action.

9. ANNUAL INVESTMENT STRATEGY

Investment Policy

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

(a) the security of capital and

(b) the liquidity of its investments.

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

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

9.4 Investment instruments identified for use in the financial year are maintained under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Authority's Treasury Management Practices – Schedules.

Creditworthiness Policy

9.5 This Authority uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

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

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

9.7 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties.

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

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

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

9.11 Investments will only be made with those bodies identified by the authority for its use through the Annual Investment Strategy.

Specified Investments	Non Specified Investments
Deposits with the Debt Management Agency Deposit Facility	
Term Deposits with UK government, UK local authorities, credit rated banks and building societies (including callable deposits and forward deals)	Non credit rated building societies
Banks nationalised by the UK government e.g. Northern Rock	
Banks eligible for support from the government (scheme closed 28-2-2010) –Bank of Scotland, Barclays, Clydesdale, Coventry Building Society, Investec Bank, , Nationwide building society, Rothchild Continuation Finance plc, Standard Life Bank, Tesco Personal Finance plc, Royal Bank of Scotland, West Bromwich Building Society, Yorkshire Building Society,	

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

Investment Strategy

9.13 In-house funds: The Authority's in-house managed funds are mainly cash-flow derived and. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

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

2011 0.50%

2012 1.00%

2013 2.25%

2014 3.25%

There is downside risk to these forecasts if economic growth is weaker than expected. There is also the risk that the MPC could decide to start raising Bank Rate in quarter 3 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public.

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

9.16 For 2011/12 the Authority has budgeted for an investment return of 0.93% on investments placed during the financial year.

End of year investment report

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

Policy on the use of external service providers

9.18 The Authority uses Sector as its external treasury management advisers. The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

Treasury Management Scheme of Delegation

Full Authority;

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy
- Approval of/amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Approving the selection of external service providers and agreeing terms of appointment.
- Reviewing the treasury management policy and procedures and making recommendations to the Authority.

Resources Committee;

- Receiving and reviewing regular monitoring reports and acting on recommendations

Role of the Section 151 officer

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing management information reports
- Reviewing the performance of the treasury management function
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- Ensuring the adequacy of internal audit and liaising with external audit
- Recommending the appointment of external service providers.

10. MINIMUM REVENUE PROVISION (MRP) STRATEGY

10.1 What is a Minimum Revenue Provision? - Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. fire stations, vehicles, equipment etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

10.2 New statutory duty - Statutory Instrument 2008 no. 414 s4 lays down that: “A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent.”

10.3 The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

10.4 New Government Guidance - Along with the above duty, the Government issued new guidance in February 2008 which requires that a Statement on the Council’s policy for its annual MRP should be submitted to the full Authority for approval before the start of the financial year to which the provision will relate.

10.5 The Authority are legally obliged to “have regard” to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Authority should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to ‘have regard’ to the guidance therefore means that: Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent;

10.6 It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance. The guidance broadly requires authorities to make revenue provision for the repayment of borrowing over a period of time which bears some relation to the finite life of the asset to which borrowing is being taken. There are four options set out in the guidance which are briefly as follows;

For borrowing after 1st April 2008 which is supported by Revenue Support Grant (RSG) and for all borrowing before 1st April 2008;

<u>Option 1 – Regulatory Method</u>

MRP calculated on the basis of the old rules as this is the basis for calculating Revenue Support Grant implications.

<u>Option 2 – CFR Method</u>

MRP can be calculated on the basis of 4% of the CFR at the end of the preceding financial year. If the CFR at that date is nil or negative, no MRP is required.

For new borrowing after 1st April 2008, under the Prudential system and for which no Government support is given;

Option 3 – Asset Life Method

Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be made in equal annual instalments over the life of the asset. In this circumstance the asset life is to be determined when MRP commences and not changed after that.

MRP should normally commence in the financial year following the one in which the expenditure is incurred. However, when borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone beginning to make MRP until that year. Investment properties should be regarded as becoming operational when they begin to generate revenues.

Option 4 – Depreciation Method

MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements.

10.7 Whilst options 1 and 2 are available for unsupported borrowing before 1st April 2008, authorities are able to use options 3 and 4 if they choose to do so.

10.8 As some types of capital expenditure incurred by the Authority 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.

10.9 A draft MRP statement for 2011/2012 is attached as Appendix B for Authority approval. The financing of the approved 2011/2012 capital programme, and the resultant prudential indicators, have been set on the basis of the content of this statement.

11. SUMMARY AND RECOMMENDATIONS

11.1 The authority is required to consider and approve the treasury management strategy to be adopted prior to the start of the financial year. This strategy must also include proposed prudential indicators and a minimum provision statement (MRP). Approval of the strategy for 2011/2012 as contained in this report will also incorporate the adoption of the revised CIPFA Treasury Management Code of Practice in 2009.

KEVIN WOODWARD
Treasurer

PRUDENTIAL AND TREASURY INDICATORS

PRUDENTIAL INDICATOR	2011/12 £m estimate	2012/13 £m estimate	2013/14 £m estimate
Capital Expenditure			
Non - HRA	6.502	5.250	3.650
HRA (applies only to housing authorities)	0	0	0
TOTAL	6.502	5.250	3.650
Ratio of financing costs to net revenue stream			
Non - HRA	4.35%	4.56%	4.93%
HRA (applies only to housing authorities)	0%	0%	0%
Capital Financing Requirement as at 31 March			
Non – HRA	31.154	33.434	34.671
HRA (applies only to housing authorities)	0	0	0
Other long term liabilities	1.885	1.847	1.836
TOTAL	33.039	35.281	36.507
Annual change in Cap. Financing Requirement			
Non – HRA	3.114	2.242	1.226
HRA (applies only to housing authorities)	0	0	0
TOTAL	3.114	2.242	1.226
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase/(decrease) in council tax (band D) per annum	(£0.47)	(£0.39)	(£0.47)
TREASURY MANAGEMENT PRUDENTIAL INDICATORS			
	£000	£000	£000
Authorised Limit for external debt -			
borrowing	36.229	37.885	39.251
other long term liabilities	1.930	1.917	1.856
TOTAL	38.159	39.802	41.107
Operational Boundary for external debt -			
borrowing	34.671	36.213	37.517
other long term liabilities	1.836	1.825	1.766
TOTAL	36.507	38.038	39.283

	upper limit %	lower limit %
Limits on borrowing at fixed interest rates	100%	70%
Limits on borrowing at variable interest rates	30%	0%
Maturity structure of fixed rate borrowing during 2011/12		
Under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	50%

MINIMUM REVENUE STATEMENT (MRP) 2011/12

Supported Borrowing

The MRP will be calculated using the regulatory method (option 1). MRP will therefore be calculated using the formulae in the old regulations, since future entitlement to RSG in support of this borrowing will continue to be calculated on this basis.

Un-Supported Borrowing (including un-supported borrowing prior to 1st April 2008)

The MRP in respect of unsupported borrowing under the prudential system will be calculated using the asset life method (option 3). The MRP will therefore be calculated to repay the borrowing in equal annual instalments over the life of the class of assets which it is funding. The repayment period of all such borrowing will be calculated when it takes place and will be based on the finite life of the class of asset at that time and will not be changed.

Finance Lease and PFI

In the case of Finance Leases and on balance sheet PFI schemes, the MRP requirement is regarded as met by a charge equal to the element of the annual charge that goes to write down the balance sheet liability. Where a lease of PFI scheme is brought, having previously been accounted for off-balance sheet, the MRP requirement is regarded as having been met by the inclusion of the charge, for the year in which the restatement occurs, of an amount equal to the write-down for the year plus retrospective writing down of the balance sheet liability that arises from the restatement. This approach produces an MRP charge that is comparable to that of the Option 3 approach in that it will run over the life of the lease or PFI scheme and will have a profile similar to that of the annuity method.

MRP will normally commence in the financial year following the one in which the expenditure was incurred. However, when borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone the beginning to make MRP until that year. Investment properties will be regarded as becoming operational when they begin to generate revenues.