ROTHERHAM BOROUGH COUNCIL – REPORT TO CABINET

1.	**Meeting:**	**Cabinet**
2.	**Date:**	**3rd November 2010**
3.	**Title:**	**Mid Year Treasury Management and Prudential Indicators Monitoring Report 2010/11**
4.	**Directorate:**	**Financial Services**

5. Summary

Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

This report meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs).

The report is structured to highlight the key changes to the Council's capital activity (the PIs), the economic outlook and the actual and proposed treasury management activity (borrowing and investment).

6. Recommendation

Cabinet is asked to:

- **Note the report and recommend that Council approve the revised prudential indicators.**

7. Proposals and Details

The Strategic Director of Finance has delegated authority to carry out treasury management activities on behalf of the Council and this report is produced in order to comply with the CIPFA Code of Practice in respect of Treasury Management in Local Authorities and the “Prudential Code”.

8. Finance

Treasury Management forms an integral part of the Council’s overall financial arrangements.

The assumptions supporting the capital financing budget for 2010/11 and for future years covered by the Council’s MTFS were reviewed in light of economic and financial conditions and the future years’ capital programme.

The Treasury Management and Investment Strategy is not forecasted to have any further revenue consequences than those identified and planned for in both the Council’s 2010/11 Revenue Budget and approved MTFS.

9. Risks and Uncertainties

Regular monitoring will ensure that risks and uncertainties are addressed at an early stage and hence kept to a minimum.

10. Policy and Performance Agenda Implications

Effective treasury management will assist in delivering the Council’s policy and performance agenda.

11. Background Papers and Consultation

Audit Committee 20 October 2010
CIPFA Code of Practice for Treasury Management in Local Authorities
Local Government Act 2003
CIPFA “Prudential Code”

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Appendix 1

Mid Year Prudential Indicators and Treasury Management Monitoring Report

1. Introduction and Background to the Report

1.1 Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

1.2 This report meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The treasury strategy and PIs were previously reported to Audit Committee, Cabinet and Council in February/March 2010.

1.3 The capital expenditure plans and prudential indicators for capital expenditure are set out initially, as these provide the framework for the subsequent treasury management activity. The actual treasury management activity follows the capital framework (and the position against treasury management indicators shown at the end).

1.4 The underlying purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the CLG Investment Guidance. These state that Members receive and adequately scrutinise the treasury management service.

1.5 The underlying economic environment remains difficult for the Council, foremost being the improving, but still challenging, concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. The downside of such a policy is that investment returns remain low.

1.6 The Strategic Director of Finance can report that the basis of the treasury management strategy, the investment strategy and the PIs are not materially changed from that set out in the approved Treasury Management Strategy (February '10).

2. Key Prudential Indicators

2.1. This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

2.2 Capital Expenditure (PI)

2.2.1 This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	2010/11 Original Estimate £m	2010/11 Revised Estimate £m
Children & Young People's Services	24.695	20.769
Environmental & Development Services	37.822	37.776
Neighbourhoods & Adult Services	42.536	47.812
Financial Services	5.598	6.210
Total	110.651	112.567

2.3 Impact of Capital Expenditure Plans

Changes to the Financing of the Capital Programme

2.3.1 The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2010/11 Original Estimate £m	2010/11 Revised Estimate £m
Total spend	110.651	112.567
Financed by:		
Capital receipts	0.673	3.635
Capital grants, capital contributions & other sources of capital funding	66.422	60.928
Total Financing	67.095	64.563
Borrowing Need	**43.556**	**48.004**
Supported Borrowing	14.459	13.957
Unsupported Borrowing	29.097	34.047
Borrowing Need	**43.556**	**48.004**

2.3.2 Actual expenditure in 2009/10 was less than anticipated and thus the increase in borrowing need for 2010/11 reflects the re-profiling of projects within the approved capital programme.

Changes to the Capital Financing Requirement (PI), External Debt and the Operational Boundary (PI)

2.3.3 The table below shows the CFR, which is the underlying external need to borrow for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

2.3.4 A key accounting change for 2009/10 was the inclusion of the Council's PFI schemes and similar arrangements on the Council's balance sheet. This has the effect of increasing the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is already included in the contract. The adjustments required were finalised during the 2009/10 accounts closedown and therefore were not reflected in the original indicator for 2010/11. The estimate for 2010/11 has been revised to incorporate this change and the effect of the increased borrowing need.

Prudential Indicator – External Debt / the Operational Boundary

RMBC	2010/11 Original Estimate £m	Current Position £m	2010/11 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR – Non Housing	294.709		300.002
CFR – Housing	286.790		286.346
Total CFR excluding PFI and similar arrangements	581.499		586.347
Net movement in CFR	32.305		36.875
Total CFR excluding PFI and similar arrangements	581.499		586.347
Cumulative adjustment for PFI and similar arrangements	-		114.146
Total CFR including PFI and similar arrangements	-		700.493
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	681.499	427.636	496.069
Other long term liabilities*	-	114.146	114.146
Total Debt 31 March	681.499	541.782	610.215

* - Includes on balance sheet PFI schemes and similar arrangements, etc. N.b. the original indicator excluded PFI and similar arrangements as the information was unavailable (see para. 2.3.4).

Former SYCC	2010/11 Original Estimate £m	Current Position £m	2010/11 Revised Estimate £m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	96.412	96.412	96.412
Other long term liabilities	0	0	0
Total Debt 31 March	96.412	96.412	96.412

3. Limits to Borrowing Activity

3.1 The first key control over the treasury activity is a PI to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent to do so.

RMBC	2010/11 Original Estimate £m	Current Position £m	2010/11 Revised Estimate £m
Gross Borrowing	491.499	427.636	496.069
Plus Other Long Term liabilities*	-	114.146	114.146
Less Investments	40.000	14.850	40.000
Net Borrowing	451.499	526.932	570.215
CFR* (year end position)	581.499	700.493	700.493

* - Includes on balance sheet PFI schemes and similar arrangements, etc. N.b. the original indicator excluded PFI and similar arrangements as the information was unavailable (see para. 2.3.4).

3.2 The Strategic Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this PI.

3.3 A further PI controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt (RMBC + Former SYCC)	2010/11 Original Indicator £m	Current Position £m	2010/11 Revised Indicator £m
Borrowing	726.315	524.048	592.481
Other long term liabilities*	0	114.146	114.146
Total	726.315	638.194	706.627

* - Includes on balance sheet PFI schemes and similar arrangements, etc. N.b. the original indicator excluded PFI and similar arrangements as the information was unavailable (see para. 2.3.4).

4. **Interest Rate Movements and Expectations**

4.1 UK short-term interest rates fluctuated in a very narrow range in the first half of the financial year. Bank Rate was held at its record low of 0.5% in spite of above target inflation and evidence of a recovery in activity in most industrialised economies and is expected to remain on hold for a considerable time.

4.2 Long-term interest rates interest rates peaked in the early stages of the financial year but have fallen back since. Although rates might be pressured lower by the effect of a fresh programme of Quantitative Easing they are still considered to be at their low point.

Medium-Term Rate Estimates

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	20 year	50 year
2009/10	0.5	0.7	1.3	3.0	4.4	4.5
2010/11	0.5	0.7	1.5	2.4	4.2	4.3
2011/12	1.1	1.3	2.2	3.1	4.8	4.9
2012/13	2.3	2.5	3.3	4.0	5.0	5.1
2013/14	3.3	3.5	4.0	4.5	5.0	5.0
2014/15	4.0	4.2	4.5	4.8	5.0	5.0
2015/16	4.0	4.2	4.5	4.5	4.8	4.7

5. Treasury Strategy 2010/11 – 2012/13

5.1 Debt Activity during 2010/11

5.1.1 The expected borrowing need is set out below:

RMBC	2010/11 Original Estimate £m	Current Position £m	2010/11 Revised Estimate £m
CFR (year end position)	581.499	700.493	700.493
Less Other Long Term Liabilities*	-	114.146	114.146
Net Adjusted CFR (y/e position)	581.499	586.347	586.347
Borrowed at 30/09/10	439.194	427.636	427.636
Under borrowing at 30/09/10	142.305	158.711	158.711
Borrowed at 30/09/10	439.194		427.636
Estimated to 31/03/11	52.305		68.433
Total Borrowing	491.499		496.069
Under borrowing at 31/03/11	90.000		90.278

* - Includes on balance sheet PFI schemes and similar arrangements, etc. N.b. the original indicator excluded PFI and similar arrangements as the information was unavailable (see para. 2.3.4).

5.1.2 The Council is currently under-borrowed although it is still anticipated this may be reduced by the end of the financial year. The delay reduces the cost of carrying the borrowed monies when yields on investments are low but borrowing rates are higher. There is also an interest rate risk, as longer term borrowing rates may rise, but this position is being monitored and the overall position carefully managed.

5.1.3 During the first half of 2010/11 the Council has taken advantage of longer term borrowing rates with the following borrowings:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£10m	Fixed interest rate	3.17%	7 years & 6 months
PWLB	£5m	Fixed interest rate	2.18%	5 years & 9 months
PWLB	£5m	Fixed interest rate	2.82%	8 years & 5 months

5.1.4 The Council has also repaid a PWLB loan of £5m with an interest rate of 4.22% when it matured. To date this has not been replaced.

5.1.5 There has been no restructuring or early repayment existing debt.

6. Investment Strategy 2010/11 – 2012/13

6.1 **Key Objectives** – The objectives of the Council's investment strategy are the safeguarding the re-payment of the principal and interest of its investments on time – the investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration, that of counterparty risk. As a result of these underlying concerns officers continue to implement an operational investment strategy which tightens the controls already in place in the approved investment strategy.

6.2 **Current Investment Position** - The Council's held £14.85m of investments at 30 September 2010 (excluding Icelandic Banks), and the constituent parts of the investment position are:

Sector	Country	Up to 1 year £m	1 - 2 years £m	2 – 3 years £m
Banks	UK	2.00	0	0
DMO	UK	5.35	0	0
Local Authorities	UK	7.50	0	0
Total		14.85	0	0

6.3 **Risk Benchmarking** – A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting.

The following reports the current position against the benchmarks.

6.3.1 **Security** – The Council monitors its investments against historic levels of default by continually assessing these against the minimum criteria used in the investment strategy. The Council's approach to risk, the choice of counterparty criteria and length of investment ensures any risk of default is minimal when viewed against these historic default levels.

6.3.2 **Liquidity** – In respect of this area the Council set liquidity facilities/benchmarks to maintain:

- Bank overdraft - £10m
- Liquid short term deposits of at least £3m available with a week's notice.

The Strategic Director of Finance can report that liquidity arrangements were adequate during the year to date.

6.3.3 **Yield** – Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

The Strategic Director of Finance can report that the return to date averages 0.40%, against a 7 day LIBID to end September 2010 of 0.425%. This is reflective of the Council's current approach to risk whereby security has been maximised by using the Debt Management Office and other Local Authorities as the principal investment counterparties.

7. Revisions to the Investment Strategy

7.1 The counterparty criteria are continually under regular review but in the light of the current market conditions no recommendations are being put to Members to revise the Investment Strategy.

8. Treasury Management Prudential Indicators

8.1 **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

	2010/11 Original Indicator %	**2010/11 Revised Indicator %**
Non-HRA	10.40	10.04
HRA	15.28	15.09

8.2 Both revised indicators reflect the impact of borrowing at rates less than originally anticipated for 2010/11.

8.3 **Prudential indicator limits based on debt net of investments**

- **Upper Limits On Fixed Rate Exposure** – This indicator covers a maximum limit on fixed interest rates.

- **Upper Limits On Variable Rate Exposure** – Similar to the previous indicator this identifies a maximum limit for variable interest rates based upon the debt position net of investments.

RMBC	**2010/11 Original Indicator**	**Current Position**	**2010/11 Revised Indicator**
Prudential indicator limits based on debt net of investments			
Limits on fixed interest rates based on net debt	100%	83.28%	100%
Limits on variable interest rates based on net debt	30%	26.18%	30%

8.4 **Maturity Structures Of Borrowing** – These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

RMBC	2010/11 Original Indicator		Current Position	2010/11 Revised Indicator	
	Lower	Upper		Lower	Upper
Maturity Structure of fixed borrowing					
Under 12 months	0%	20%	4.46%	0%	20%
12 months to 2 years	0%	25%	4.46%	0%	25%
2 years to 5 years	0%	30%	7.43%	0%	30%
5 years to 10 years	0%	35%	14.86%	0%	35%
10 years to 20 years	0%	40%	4.46%	0%	40%
20 years to 30 years	0%	45%	6.92%	0%	45%
30 years to 40 years	0%	50%	1.49%	0%	50%
40 years to 50 years	10%	60%	25.65%	10%	60%
50 years and above	30%	100%	30.30%	15%	100%

8.4.1 Due to the availability of fixed rate borrowing for periods beyond 50 years it is recommended the lower limit on fixed borrowing is reduced to 15%.

8.4.2 In 2010/11 as in previous years the original limits were set as jointly applicable to the combined Council and the former SYCC debt. The former SYCC account is due to be wound up by the end of 2020/21 thus the purpose behind setting limits to reduce short-term refinancing risk is less applicable under these circumstances.

8.4.3 The maturity structure is now largely fixed as the need and indeed opportunities to re-finance within the remaining 11 years will be limited. As a result future limits will be set in line with the on-going maturity profile.

Former SYCC	2010/11 Original Indicator		Current Position	2010/11 Revised Indicator	
	Lower	Upper		Lower	Upper
Maturity Structure of fixed borrowing					
Under 12 months	0%	20%	0%	0%	0%
12 months to 2 years	0%	25%	0%	0%	0%
2 years to 5 years	0%	30%	0%	0%	0%
5 years to 10 years	0%	35%	79.58%	0%	85%
10 years to 20 years	0%	40%	-	-	-
10 years to 11 years	-	-	20.42%	0%	25%
20 years to 30 years	0%	45%	-	-	-
30 years to 40 years	0%	50%	-	-	-
40 years to 50 years	10%	60%	-	-	-
50 years and above	30%	100%	-	-	-

8.5 **Total Principal Funds Invested** – These limits are set to reduce the need for early sale of an investment, and show limits to be placed on investments with final maturities beyond each year-end.

RMBC	2010/11 Original Indicator £m	Current Position £m	2010/11 Revised Indicator £m
Maximum principal sums invested > 364 days[1]	12	12	12
Comprising			
Cash deposits	12	0	12
Forward purchase agreements	0	0	0

[1] Maximum limit of 100% applies to each period. The principal amount given is the limit for investments that have maturities of longer than one year at year end.

8.5.1 The Council currently has no sums invested for periods exceeding 364 days due to market conditions. To allow for any changes in those conditions the indicator has been left unchanged.