ROTHERHAM BOROUGH COUNCIL – REPORT TO MEMBERS

1.	**Meeting:**	**Cabinet**
2.	**Date:**	**23rd February 2011**
3.	**Title:**	**Prudential Indicators and Treasury Management and Investment Strategy 2011/12 to 2013/14**
4.	**Directorate:**	**Financial Services**

5. Summary

In accordance with the Prudential Code for Capital Finance, the Secretary of State's Guidance on Local Government Investments, the CIPFA Code of Practice for Treasury Management in Local Authorities and with Council policy, the Strategic Director of Finance is required, prior to the commencement of each financial year to seek the approval of the Council to the following:

i. The Prudential Indicators and Limits for 2011/12 to 2013/14 (Appendix A)
ii. A Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP (Appendix A)
iii. An Annual Treasury Management Strategy in accordance with the CIPFA Code of Practice on Treasury Management including the Authorised Limit (Appendix B)
iv. An Investment Strategy in accordance with the CLG investment guidance (Appendix B)

6. Recommendations

Cabinet is asked to recommend Council:

1. **Approve the prudential indicators and limits for 2011/12 to 2013/14 contained in Appendix A to the report**

2. **Approve the Minimum Revenue Provision Statement contained in Appendix A which sets out the Council's policy on MRP**

3. **Approve the Treasury Management Strategy for 2011/12 to 2013/14 and the Authorised Limit Prudential Indicator (Appendix B)**

4. **Approve the Investment Strategy for 2011/12 to 2013/14 (Appendix B and Annex B1)**

7. Proposals and Details

The Strategic Director of Finance has delegated authority to carry out treasury management activities on behalf of the Council. This report is produced in order to comply with the CIPFA Code of Practice for Treasury Management in Local Authorities, the CIPFA Prudential Code for Capital Finance in Local Authorities and the CLG Investment Guidance.

The Council's 2010/11 Treasury Management Strategy was approved by Council on 3 March 2010, whilst a Mid Year report which updated the 2010/11 approved indicators was approved by Council on 8 December 2010. This report updates the currently approved indicators for the period 2010/11 to 2012/13 and introduces new indicators for 2013/14.

The Strategy was drawn up in association with the Council's treasury management advisors, Sector Treasury Services Ltd, part of the The Capita Group plc. In October 2010 ICAP Securities Ltd agreed to transfer its treasury consultancy services division (Butlers) to Sector Treasury Services Ltd and the Council's existing contract with Butlers was novated to Sector Treasury Services Ltd.

7.1 Background

During 2009 three key documents were published, the first two of which resulted in the main from the impact of the Icelandic banking issues:

- the Audit Commission report 'Risk and Return',
- the CLG Select Committee report on local authority investments; and,
- CIPFA's revised Prudential Code.

In addition CIPFA fully revised its guidance on Treasury Management and published the following two documents towards the end of 2009:

- Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes; and,
- Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities

In March 2010 CLG confirmed changes to the Capital Finance system which included revisions to CLG's Investment Guidance. These were in line with the outcomes from the publications & reports issued (and referred to above) and take account of the changes to CIPFA's Code of Practice and Guidance Notes.

This report is fully reflective of the changes to guidance issued by CIPFA and the CLG.

7.2. Review of the Currently Approved Investment Strategy

Following the events of October 2008 and in light of the current and on-going economic & financial climate, the Strategic Director of Finance took a series of actions to evaluate the Council's Investment Strategy and manage the treasury management function.

The Council's investment policy's continuing primary governing principle is the **security** of its investments, although yield or return on investments is also a consideration.

The revised operational guidelines enhanced the weighting towards 'security' even further at the expense of yield or return. Although seeking to minimise investment default risk, it does not eliminate it. Eliminating risk altogether is only possible if the Council only invested any surplus funds with the Bank of England's Debt Management Office (DMO).

These actions were reinforced within the currently approved strategy whereby the criteria for choosing counterparties were tightened. We continue to operate the treasury management guidelines well within the boundaries set by the approved selection criteria so as to minimise the risks inherent in operating a treasury management function during volatile and adverse economic and financial conditions. To this end, the Council has continued to invest any surplus funds primarily with the Bank of England's Debt Management Office.

In addition, investment levels over the last 12 months remain low as market conditions still dictate that it continues to be prudent to defer borrowing plans and to fund on-going capital commitments through the use of the Council's internal cash-backed resources.

Actual returns on investment opportunities remain subdued when compared to previous years but have been effectively and prudently managed by significantly reducing expected capital financing costs. This has enabled the Council to stay within its capital financing budget cash limit. This is a significant achievement given the difficult economic and financial conditions prevailing throughout the current financial year.

Counterparty List

At the present time the Council's counterparty list for investments uses the following criteria:

	Fitch	Moody's	Standard & Poor's	Money Limit	Time Limit
Upper Limit Category	F1+/AA-	P-1/Aa3	A-1+/AA-	£20m	5years
Middle Limit Category	F1/A-	P-1/A3	A-1/A-	£10m	364 days
Lower Limit Category *	All Building Soc's ranked 1 to 10 All Building Soc's ranked 11 to 20			£5m £1m	6 months 3 months
Debt Management Office	-	-	-	Unlimited **	6 months
Money Market Funds ***	-	-	-	£20m	n/a
UK Single Tier & County Councils	-	-	-	£20m	5 years
Council's Bank (Co-op)	-	-	-	£10m	364 days

The above money limits are exclusive of bank balances held by schools

*	Based on maximum of 20% of the investment portfolio

**	Provides maximum flexibility

***	Based on maximum of 20% of the investment portfolio

Taking into account the current market conditions and future economic and financial outlook, whilst retaining sufficient flexibility to react to changing market conditions, it is proposed to retain the currently approved criteria.

In essence, the counterparty list provides the Council with the opportunity to maximise security of any invested funds by allowing all funds to be placed with the DMO and UK Single Tier and County Councils and reducing the maximum level and time of investments that can be placed with financial institutions that do not meet all the upper limit credit rating criteria

7.3 Prudential Indicators

7.3.1 Capital Expenditure, Capital Financing Requirement & Affordability

The Prudential Indicators submitted for approval are summarised as:

	2010/11 Revised Dec '10	2010/11 Revised	2011/12 Estimated	2012/13 Estimated	2013/14 Estimated
Capital Expenditure	£112.567m	£109.141m	£63.911m	£43.314m	£32.034m
Capital financing requirement	£700.493m	£700.218m	£716.685m	£710.584m	£703.009m
Authorised limit for external debt (RMBC + Former SYCC)	£706.627m	£706.627m	£825.930m	£814.549m	£678.161m
Operational boundary for external debt (RMBC)	£610.215m	£553.370m	£611.837m	£645.736m	£678.161m
Operational boundary for external debt (Former SYCC)	£96.412m	£96.412m	£96.412m	£96.412m	£96.412m
Ratio of financing costs to net revenue stream – Non HRA	10.04%	9.10%	9.90%	11.06%	11.78%
Ratio of financing costs to net revenue stream – HRA	15.09%	15.07%	15.78%	16.52%	16.20%
Incremental impact of capital investment decisions on the Band D Council Tax*	£20.59	£21.04	£23.73	£16.48	£0.78
Incremental impact of capital investment decisions on housing rents levels*	£0.00	£0.00	£0.00	£0.00	£0.00

* Original estimates for 2010/11

It should be noted that only schemes in the Council's approved capital programme are included in the indicators as listed and that there may be further schemes pending approval. Any additional approvals will normally have to be funded from unsupported borrowing as all identified available resources have been allocated. This would impact on the prudential indicators above.

It should further be noted that the impact on Band D Council Tax, as shown in the table above, indicates the impact of the Council's capital investment plans as already budgeted for within the proposed Budget for 2011/12 and the Council's Medium Term Financial Strategy, **and does not indicate additional requirements of Rotherham council tax payers**.

7.3.2 Treasury Management Prudential Indicators and Limits on Activity

There are four treasury prudential indicators, the purpose of which 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. The indicators submitted for approval are shown below.

The limits for interest rate exposures are consistent with those approved within the Mid Year report on the 2010/11 Strategy; in line with the requirements of the new Code the maturity structure detail has been updated and extended; and the investment limits beyond 364 days have been reduced to reflect the expected investment strategy.

RMBC	**2011/12**	**2012/13**	**2013/14**
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rate debt based on fixed net debt	100%	100%	100%
Limits on variable interest rate debt based on variable net debt	30%	30%	30%

RMBC Maturity Structure of fixed interest rate borrowing 2011/12		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	25%
2 years to 5 years	0%	30%
5 years to 10 years	0%	35%
10 years to 20 years	0%	40%
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	15%	100%

RMBC Maximum Funds invested > 364 days			
	1 to 2 years	2 to 3 years	3 to 5 years
Funds invested > 364 days	£m 10	£m 8	£m 6

Former SYCC	2011/12	2012/13	2013/14
Interest Rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	30%	30%	30%

Maturity Structure of fixed interest rate borrowing 2011/12		
	Lower	**Upper**
Under 12 months	0%	50%
12 months to 2 years	0%	70%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%

7.4 Minimum Revenue Provision Policy

Communities & Local Government Regulations require Full Council to approve a Minimum Revenue Provision Statement in advance of each financial year. The policy put forward for approval is set out in section 11 of Appendix A.

8. Finance

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

The assumptions supporting the capital financing budget for 2011/12 and for the future years covered by the MTFS of the Council have been reviewed in light of the current economic and financial conditions and the revised future years' capital programme.

The proposed 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 2011/12 Revenue Budget and approved MTFS.

9. Risks and Uncertainties

The proposed Treasury Management and Investment Strategy seeks to minimise the risks inherent in operating a Treasury Management function during these difficult economic and financial conditions.

Operational Treasury Management guidelines will continue to be kept in place and reviewed to ensure they are appropriate given the circumstances faced, supported by regular monitoring to ensure that any 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 Councils' policy and performance agenda.

11. Background Papers and Consultation

Audit Committee – 17 February & 20 October 2010
Cabinet – 24 February & 3 November 2010
Council – 3 March & 8 December 2010
CIPFA – The Prudential Code for Capital Finance in Local Authorities
CIPFA – Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes
CIPFA – Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities
CLG Investment Guidance – March 2010
The Local Government Act 2003

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Appendix A

PRUDENTIAL INDICATORS 2011/12 TO 2013/14

Introduction

1. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and prepare and publish prudential indicators. Each indicator either summarises the expected activity or introduces limits upon the activity, and reflects the underlying capital programme. This report updates currently approved indicators and introduces new indicators for 2013/14.

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 2011/12 to 2013/14 is included as Appendix B to complement these indicators. Some of the prudential indicators are shown in the Treasury Management Strategy to aid understanding.

The Capital Expenditure Plans

3. The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

   - Service objectives (e.g. strategic planning);
   - Stewardship of assets (e.g. asset management planning);
   - Value for money (e.g. option appraisal)
   - Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
   - Affordability (e.g. implications for the council tax and rents)
   - Practicality (e.g. the achievability of the forward plan).

4. The revenue consequences of capital expenditure, particularly the unsupported expenditure, will need to be paid for from the Council's own revenue resources.

5. This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual expenditure will add to the Council's borrowing need.

6. 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 estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For example, anticipated asset sales resulting from the Council's on-going asset rationalisation programme may be deferred due to the on-going impact of the current economic & financial conditions on the property market.

7. The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
Children & Young People's Services	17.514	5.896	6.315	2.500
Env & Dev Services	31.423	29.848	16.335	10.977
Neighbourhoods & Adult Services	52.195	23.650	18.119	17.012
Financial Services	8.009	4.517	2.545	1.545
Total expenditure	**109.141**	**63.911**	**43.314**	**32.034**
Capital receipts	4.243	1.431	1.458	1.237
Capital grants, capital contributions & sources other capital funding	58.894	35.141	36.576	26.832
Total financing	**63.137**	**36.572**	**38.034**	**28.069**
Net financing need for the year	**46.004**	**27.339**	**5.280**	**3.965**

8. Other long term liabilities - The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

<u>The Capital Financing Requirement (the Council's Borrowing Need)</u>

9. 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 the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.

10. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a "borrowing facility" and so the Council is not required to separately borrow for this scheme. The Council currently has £114.146m within the CFR in respect of such schemes.

11. The Council is asked to approve the CFR projections below:

	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
CFR – Non Housing	297.528	312.079	306.392	299.231
CFR – Housing	288.544	290.460	290.046	289.632
Total CFR	**586.072**	**602.539**	**596.438**	**588.863**
Movement in CFR	**36.599**	**16.467**	**-6.101**	**-7.575**
Net financing need for the year (above)	46.004	27.339	5.280	3.965
Less Non Housing MRP/VRP and other financing movements	9.405	10.872	11.381	11.540
Total movement	**36.599**	**16.467**	**-6.101**	**-7.575**

12. 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 - MRP). In addition, it is also allowed to make additional voluntary payments (VRP) where it is prudent to do so.

13. CLG Regulations require Full Council to approve an MRP Statement in advance of each year. Detailed rules have been replaced by a single duty to charge an amount of MRP which the Council considers 'prudent'. The Strategic Director of Finance will, where it is prudent to do so, use discretion to review the overall financing of the capital programme and the opportunities afforded by the regulations to maximise the benefit to the Council whilst ensuring it meets its duty to charge a 'prudent' provision.

    The Council is recommended to approve the following MRP policy in relation to the charge for both the 2010/11 & 2011/12 financial years:

    (a) The MRP charge in relation to borrowing for capital expenditure incurred prior to 2007/08 will be unaffected by the regulations;

    (b) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by both supported and unsupported borrowing will be calculated using the expected useful life of the asset at the point the asset is brought into use; and

    (c) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by a 'capitalisation directive' (e.g. equal pay) will be calculated on the basis of equal instalments over the specified period(s) set down within the regulations.

Affordability Prudential Indicators

14. The previous sections cover those prudential indicators that are used to monitor the impact the capital programme has on the Council's borrowing position.

15. Further indicators are used to provide an indication of the impact the capital programme has on the overall Council's finances. The Council is asked to approve the following indicators.

16. **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 of the Council. The trend reflects the Council's prioritisation of its capital investment plans.

Ratio of financing costs to Net Revenue Stream				
	2010/11 Revised Dec '10 %	2011/12 Estimated %	2012/13 Estimated %	2013/14 Estimated %
Non-HRA	10.04	9.90	11.06	11.78
HRA	15.09	15.78	16.52	16.20

17. The estimates of financing costs include all current commitments, the proposals contained in the proposed 2011/12 Revenue Budget and updated future years' Capital Programme.

18. **Estimates of the incremental impact of capital investment decisions on the Council Tax** – This indicator identifies the revenue costs associated with proposed changes to the capital programme compared to the Council's existing commitments and current plans.

    Only schemes in the Council's approved capital programme are included in the indicators and there may be further schemes pending approval. Any additional approvals will normally have to be funded from unsupported borrowing as all identified available resources have been allocated. This would impact on the prudential indicators above.

    The impact on Band D Council Tax, as shown in the table below, indicates the impact of the Council's capital investment plans as already budgeted for within the proposed Budget for 2011/12 and the Council's Medium Term Financial Strategy, **and does not indicate additional requirements of Rotherham council tax payers**.

Incremental impact of capital investment decisions on the Band D Council Tax					
	Original 2010/11 £	**Revised 2010/11 £**	**Proposed Budget 2011/12 £**	**Projection 2012/13 £**	**Projection 2013/14 £**
Council Tax - Band D	20.59	21.04	23.73	16.48	0.78

For each financial year the impact at Band A is £14.02, £15.82, £10.99 and £0.52 respectively.

19. **Estimates of the incremental impact of capital investment decisions on Housing Rent levels** – Similar to the Council tax calculation, this indicator identifies the revenue cost of proposed changes in the housing capital programme compared to the Council's existing approved commitments and current plans expressed in terms of the impact on weekly rent levels.

Incremental impact of capital investment decisions on the Housing Rent levels					
	Original 2010/11 £	**Revised 2010/11 £**	**Proposed Budget 2011/12 £**	**Projection 2012/13 £**	**Projection 2013/14 £**
Weekly Housing Rent levels	0.00	0.00	0.00	0.00	0.00

Appendix B

TREASURY MANAGEMENT STRATEGY 2011/12 – 2013/14

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

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 – revised November 2009). The Council adopted the Code of Practice on Treasury Management (Cabinet, March 2004) and adopted the revisions to the Code in March 2010.

3. The Council's constitution (via Financial Regulations) requires an annual strategy to be 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 report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code is that there is a mid-year monitoring report.

4. This Strategy covers:

   (a) The Council's debt and investment projections;
   (b) The Council's estimates and limits to borrowing activity;
   (c) The expected movement in interest rates;
   (d) The Council's borrowing and debt strategy
   (e) The Council's investment strategy;
   (f) Interest rate movement sensitivity
   (g) Treasury Management prudential indicators and limits on activity;
   (h) Treasury performance indicators
   (i) Treasury Management advisers
   (j) Member and officer training

(a) Debt and Investment Projections 2011/12 – 2013/14

5. 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 for both the Council and the ex-SYCC debt that the Council administers on behalf of the other South Yorkshire local authorities. The table also highlights the expected level of investment balances.

RMBC	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
External Debt				
Debt at 1 April	412.636	437.636	494.103	528.002
Expected change in debt	25.000	56.467	33.899	32.425
Debt at 31 March	437.636	494.103	528.002	560.427
Investments				
Total Investments at 31 March	5.000	30.000	30.000	30.000
Investment change	-10.979	25.000	0	0

Ex SYCC	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
External Debt				
Debt at 1 April	102,012	96,012	96,412	96,412
Expected change in debt	-5,600	0	0	0
Debt at 31 March	96,412	96,412	96,412	96,412
Investments				
Total Investments at 31 March	0	0	0	0
Investment change	0	0	0	0

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

	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
Revenue Budgets				
Interest on Borrowing	20.796	22.785	26.784	29.215
Related HRA Charge	-11.475	-12.814	-14.310	-14.987
Net General Fund Borrowing Cost	9.231	9.971	14.474	14.228
Investment Income	0.133	0.100	0.150	0.200

(b) <u>Limits to Borrowing Activity</u>

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

8. 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 2009/10 and the following two financial years. This allows some flexibility for limited early borrowing for future years.

RMBC	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
Gross Borrowing	437.636	494.103	528.002	560.427
Investments	5.000	30.000	30.000	30.000
Net Borrowing	432.636	464.103	498.002	530.427
CFR (excluding other long term liabilities)	586.072	602.539	596.438	588.863
CFR less Net Borrowing	**153.436**	**138.436**	**98.436**	**58.436**

9. The Strategic Director of Finance reports that the Council has complied with this indicator in the current year and does not envisage difficulties for the future. This view takes into account approved commitments and existing plans.

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

11. **The Authorised Limit for External Debt** – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all council's plans, or those of a specific council, although no control has yet been exercised.

12. **The Operational Boundary for External Debt** –This indicator is based on the probable external debt during the course of the year; it is not a limit.

    The Council is asked to approve the following Authorised Limit and Operational Boundary:

Authorised Limit for External Debt (RMBC + Former SYCC)	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
Borrowing	592.481	711.784	700.403	688.863
Other long term liabilities	114.146	114.146	114.146	114.146
Total	706.627	825.930	814.549	803.009

Operational Boundary for External Debt (RMBC)	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
Borrowing	441.224	497.691	531.590	564.014
Other long term liabilities	114.146	114.146	114.146	114.146
Total	555.370	611.837	645.736	678.160

Operational Boundary for External Debt (Former SYCC)	2010/11 Revised £m	2011/12 Estimated £m	2012/13 Estimated £m	2013/14 Estimated £m
Borrowing	96.412	96.412	96.412	96.412
Other long term liabilities	0	0	0	0
Total	96.412	96.412	96.412	96.412

13. Borrowing in advance of need - The Council has some flexibility to borrow funds this year for use in future years. The Strategic Director of Finance may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or help meet budgetary constraints. Whilst the Strategic Director of Finance will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund debt maturities. Borrowing in advance will be made within the constraints that

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and

- Would not look to borrow more than 18 months in advance of need.

These limits have been set looking ahead to the medium to long-term but in the short-term it is expected that borrowing in advance will be limited to no more than 10% and would not be undertaken more than 3 months in advance of need.

14. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year and annual reporting mechanism.

(c) <u>Expected Movement in Interest Rates</u>

Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates *		
		3 month	1 year	5 year	20 year	50 year
2010/11	0.5	0.7	1.5	2.6	4.6	4.7
2011/12	0.7	1.0	1.8	3.3	5.3	5.4
2012/13	1.7	2.0	2.8	4.2	5.5	5.6
2013/14	3.1	3.2	3.7	4.8	5.6	5.7
2014/15	4.0	4.2	4.5	5.6	5.6	5.8
2015/16	4.0	4.2	4.2	5.3	5.5	5.5

* Borrowing rates

15. The Office for Budget Responsibility view of the economy's recovery prospects over the short and medium term is subdued and moves to cut the size of the public sector deficit will reduce economic activity in the medium term.

16. The Bank of England expects inflation will remain above target until 2012 and inflation performance remains a key risk to the future course of interest rates. Nevertheless, it is expected that the MPC will be prepared to hold rates at very low levels until later in 2011

17. Short-term rates to one year are expected to remain at current levels for some time. The recovery in the economy has commenced and recent growth data has come in at the high side of expectations. Nevertheless, this higher rate is unlikely to be sustained and growth is expected to slow again.

18. The outlook for long-term interest rates is favourable in the near future but is expected to become less so during the latter part of 2011.

(d) Borrowing and Debt Strategy 2011/12 – 2013/14

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

20. The Strategic Director of Finance, 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 shorter term fixed rates may provide lower cost opportunities in the short to medium term.

(e) Investment Strategy 2011/12 – 2013/14

21. The primary objectives of the Council's investment strategy are:

    - Firstly to safeguard the timely repayment of principal and interest (security);
    - Secondly to ensure adequate liquidity; and,
    - Thirdly to produce an investment return (yield)

22. As part of this Strategy Members need to consider and approve security and liquidity benchmarks in addition to yield benchmarks which are currently widely used to assess investment performance and have previously been reported to Members. The proposed benchmarks are set down in Annex B2.

23. 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 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 of Annex B1.

- 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 as set out in Annex B1.

24. The Strategic Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are different to those which are used to select Specified and Non-Specified investments.

25. The rating criteria use 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. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

26. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change) and rating outlooks (notification of a possible long term change) are provided to officers almost immediately after they occur and this information is considered before any dealing.

27. The criteria for providing a portfolio of high quality investment counterparties (both Specified and Non-Specified investments) is:

- **Banks** – the Council will use banks which are rated by at least two rating agencies and have at least the following Fitch, Moody's and Standard and Poors' ratings (where rated):

	Fitch	Moody's	Standards & Poor's
Short-term	F1	P-1	A-1
Long-term	A-	A3	A-
Individual	C	n/a	n/a
Support	3	n/a	n/a
Financial Strength	n/a	C	n/a

  To allow for the day to day management of the Council's cash flow the Council's own bank, **the Co-operative Bank plc** will also be retained on the list of counterparties if ratings fall below the above minimum criteria.

- **Building Societies** – the Council will use the top 20 Building Societies ranked by asset size but restricted to a maximum of 20% of the investment portfolio

- **Money Market Funds** – AAA – restricted to a maximum of 20% of the investment portfolio

- **UK Government –** Debt Management Office

- **UK Single Tier & County Councils –** (i.e. Metropolitan Districts, London Boroughs, County Councils, Unitary Authorities)

A limit of 35% will be applied to the use of Non-Specified investments within the investment portfolio, excluding day to day cash management through the Council's own bank, the Co-operative Bank plc.

28. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market and sovereign information will continue to be applied before making any specific investment decision from the agreed portfolio of counterparties.

29. The time and monetary limits for institutions on the Council's Counterparty List are as follows and represent no change from those currently approved (these will cover both Specified and Non-Specified Investments):

	Fitch	Moody's	Standard & Poor's	Money Limit	Time Limit
Upper Limit Category	F1+/AA-	P-1/Aa3	A-1+/AA-	£20m	5years
Middle Limit Category	F1/A-	P-1/A3	A-1/A-	£10m	364 days
Lower Limit Category *	All Building Soc's ranked 1 to 10 All Building Soc's ranked 11 to 20			£5m £1m	6 mths 3 mths
Debt Management Office	-	-	-	Unlimited **	6 months
Money Market Funds ***	-	-	-	£20m	n/a
UK Single Tier & County Councils	-	-	-	£20m	5 years
Council's Bank (Co-op)	-	-	-	£10m	364 days

The above money limits are exclusive of bank balances held by schools
* Based on maximum of 20% of the investment portfolio
** Provides maximum flexibility
*** Based on maximum of 20% of the investment portfolio

30. The proposed criteria for Specified and Non-Specified investments and monitoring of counterparties are shown in Annex B1 for Member approval.

31. 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.

32. 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 long term investment limits.

(f) Sensitivity to Interest Rate Movements

33. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	2011/12 Estimated + 1% £m	2011/12 Estimated - 1% £m
Revenue Budgets		
Interest on Borrowing	0.334	-0.334
Related HRA Charge	0.225	-0.225
Net General Fund Borrowing Cost	0.109	-0.109
Investment income	0.200	0.000

(g) Treasury Management Prudential Indicators and Limits on Activity

34. There are four further treasury activity limits, which were previously prudential indicators. The purpose of these limits are 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 limits are:

- Upper limits on fixed interest rate exposure – This identifies a maximum limit for fixed interest rates based upon the fixed debt position net of fixed interest rate investments.

- Upper limits on variable interest rate exposure – as above this limit covers a maximum limit on variable interest rates based upon the variable debt position net of variable interest rate investments.

- 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 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.

For the purposes of these indicators the Council's market debt is treated as fixed. Whilst a percentage of the debt may be subject to variation on specific call dates each year, over the Strategy period any such variations are thought unlikely and the debt can be regarded as fixed.

35. The activity limits (prudential indicators) for Member approval are as follows:

RMBC	2011/12	2012/13	2013/14
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rate debt based on fixed net debt	100%	100%	100%
Limits on variable interest rate debt based on variable net debt	30%	30%	30%

RMBC Maturity Structure of fixed interest rate borrowing 2011/12		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	25%
2 years to 5 years	0%	30%
5 years to 10 years	0%	35%
10 years to 20 years	0%	40%
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	15%	100%

RMBC Maximum Funds invested > 364 days			
	1 to 2 years	2 to 3 years	3 to 5 years
Funds invested > 364 days	£m 10	£m 8	£m 6

Former SYCC	2011/12	2012/13	2013/14
Interest Rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on total debt	100%	100%	100%
Limits on variable interest rates based on total debt	30%	30%	30%

Former SYCC Maturity Structure of fixed interest rate borrowing 2011/12		
	Lower	**Upper**
Under 12 months	0%	50%
12 months to 2 years	0%	70%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%

(h) <u>Treasury Performance Indicators</u>

36. 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. The results of the following two indicators will be reported in the Treasury Annual Report for 2010/11:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Investments – Internal returns above the 7 day London Interbank Bid rate (LIBID) which is the rate at which a bank is willing to borrow from other banks

(i) <u>Treasury Management Advisers</u>

37. The Council uses Sector Treasury Services Ltd as its treasury management advisors. In October 2010 ICAP Securities Ltd agreed to transfer its treasury consultancy services division (Butlers) to Sector Treasury Services Ltd. The Council's existing contract with Butlers was novated to Sector Treasury Services Ltd which is a subsidiary of The Capita Group plc.

38. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;

- Economic and interest rate analysis;

- Debt services which includes advice on the timing of borrowing;

- Debt rescheduling advice surrounding the existing portfolio;

- Generic investment advice on interest rates, timing and investment instruments; and,

- Credit rating/market information service comprising the three main credit rating agencies.

39. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is provided to the Council under a contractual agreement which is subject to regular review.

(j) Member and Officer Training

40. The Council recognises the increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. In response to the revised treasury management

guidance and advice, the Council has been proactively identifying opportunities to enhance the level of expertise and knowledge of treasury management matters for both Members and officers through the provision of suitable training and development. To this end, the Council has:

- Regularly reported to Members of the Council's Audit Committee on treasury management matters over the last two to three years;

- Responded positively to the various treasury management consultation processes and external reviews conducted;

- Supported the Capital and Treasury Management Accountant to successfully undertake the CIPFA accredited Association of Corporate Treasurers' course 'Certificate in International Treasury Management – Public Finance' so as to enhance the expertise and knowledge of officers undertaking treasury management functions; and,

- Put in place arrangements to provide Members of the Audit Committee and other Members with training and development sessions to enhance their awareness of treasury management matters in a local government environment.

Annex B1

Treasury Management Practice (TMP) 1 (5) – Credit and Counterparty Risk Management

1. Overview

The Office of the Deputy Prime Minister (now CLG) issued Revised Investment Guidance in March 2010, and this forms the structure of the Council's policy below.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield.

In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council has adopted the Code will apply its principles to all investment activity.

In accordance with the Code, the Strategic Director of Finance has reviewed and prepared its treasury management practices. This part, TMP 1(5), covering investment counterparty policy requires approval each year.

2. Annual Investment Strategy

The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The guidelines for investment decision making, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which investments can be made.
- The specified investments the Council may use.
- The non-specified investments the Council may use.

This strategy is to be approved by full Council.

The investment policy proposed for the Council is detailed in the paragraphs below.

2.1 Strategy Guidelines

The main strategy guidelines are contained in the body of the treasury strategy statement.

2.2 Specified Investments

These investments are sterling investments of not more than one-year maturity. If they are for a longer period then the Council must have the right to be repaid within 12 months if it wishes.

These are low risk assets where the possibility of loss of principal or investment income is small.

These would include the following investment categories:

1. The UK Government Debt Management Office.

2. UK Single Tier & County Councils – (i.e. Metropolitans District, London Boroughs, County Councils, Unitary Authorities)

3. Money Market Funds that have been awarded AAA credit ratings by Standard and Poor's, Moody's or Fitch rating agencies and restricted to 20% of the overall investment portfolio

4. A bank or a building society that has been awarded a minimum short-term rating of F1 by Fitch, P-1 by Moody's and A-1 by Standard and Poor's rating agencies. For Building Societies investments will be restricted to 20% of the overall investment portfolio and:

   - a maximum of £5m for a period not exceeding 6 months if the society is ranked in the top 10 by asset size; or
   - a maximum of £1m and a period not exceeding 3 months if the society is ranked 11 to 20 by asset size.

2.3 Non-Specified Investments

Non-specified investments are any other type of investment not defined as specified above.

The criteria supporting the selection of these investments and the maximum limits to be applied are set out below.

Non specified investments would include any sterling investments with:

1. A bank that has been awarded a minimum long term credit rating of AA- by Fitch, Aa3 by Moody's and AA- by Standard & Poor's for deposits with a maturity of greater than 1 year.

2. The Council's own bank, the Co-operative Bank plc, if ratings fall below the above minimum criteria.

3. A Building Society which is ranked in the top 20 by asset size. Investments will be restricted to 20% of the overall investment portfolio and:

- a maximum of £5m for a period not exceeding 6 months if the society is ranked in the top 10 by asset size; or
- a maximum of £1m and a period not exceeding 3 months if the society is ranked 11 to 20 by asset size.

3 The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly. The Council receives credit rating information from the Council Treasury Management advisors on a daily basis, as and when ratings change, and counterparties are checked promptly.

On occasions ratings may be downgraded after the date on which an investment has been made. It would be expected that a minor downgrading would not affect the full receipt of the principal and interest.

Any counterparty failing to meet the minimum criteria will be removed from the list immediately by the Strategic Director of Finance, and new counterparties will be added to the list if and when they meet the minimum criteria.

Annex B2

Security, Liquidity and Yield Benchmarking

A developmental area for reporting is Member consideration and approval of security and liquidity benchmarks in addition to those previously reported for yield.

These benchmarks are targets and so may be exceeded from time to time with any variation reported, with supporting reasons in Mid-Year & Annual Treasury Reports.

1. **Security and liquidity** – these benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators, e.g. the maximum funds which may be invested for more than 364 days, the limit on the use of Non-specified investments, etc.

   However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

1.1 Security – Security is currently evidenced by the application of minimum criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poor's). Whilst this approach embodies security considerations, benchmarking levels of risk is more subjective and therefore problematic.

One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment products for each of Fitch, Moody's & Standard and Poors long term rating category over the period 1990 to 2009.

Credit Rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.01%	0.05%	0.10%	0.17%
AA	0.03%	0.06%	0.08%	0.14%	0.20%
A	0.08%	0.22%	0.37%	0.52%	0.70%
BBB	0.24%	0.68%	1.19%	1.79%	2.42%
BB	1.22%	3.24%	5.34%	7.31%	9.14%
B	4.06%	8.82%	12.72%	16.25%	19.16%
CCC	24.03%	31.91%	37.73%	41.54%	45.22%

The Council's minimum long term rating criteria (over one year) is currently "AAA" meaning the average expectation of default for a three year investment in a counterparty with a "AAA" long term rating would be 0.05% of the total investment (e.g. for a £1m investment the average loss would be £500).

The Council's minimum long term rating criteria (up to one year) is currently "BBB" meaning the average expectation of default for such an investment would be 0.24% (e.g. for a £1m investment the average loss would be £2,400).

These are only averages but do act as a proxy benchmark for risk across the investment portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- **0.08% historic risk of default when compared to the whole portfolio, which means that for a £1m investment the average loss would be £800.**

In addition, the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum risk of default	0.09%	0.01%	0.05%	0.10%	0.17%

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Annual Report.

1.2 Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable the Council at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

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

A method of monitoring the availability of liquidity and the inherent risks arising from the investment periods within the portfolio is to use the Weighted Average Life (WAL) of the portfolio. This measures the time period over which half the investment portfolio would have matured and become liquid

A shorter WAL generally represents less risk and in this respect the proposed benchmark to be used is:

- The Council's WAL benchmark for 2011/12 is estimated to be 0.08 years which means that at any point in time half the investment portfolio would be available within 28 days.

2. **Yield** – These benchmarks are currently widely used to assess investment performance and the Council's local measure of yield is:

- Investments – Internal returns above the 7 day London Interbank Bid rate (LIBID) which is the rate at which a bank is willing to borrow from other banks