

EAST LONDON WASTE AUTHORITY

7 FEBRUARY 2011

FINANCE DIRECTOR'S REPORT

TREASURY MANAGEMENT STRATEGY 2011/12 AND PRUDENTIAL CODE INDICATORS 2011/12 TO 2013/14	FOR APPROVAL
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1 Introduction

- 1.1 This report sets out ELWA's Treasury Management Strategy for 2011/12 together with the Prudential Indicators for Treasury Management. The report encompasses:
- New borrowing requirements and debt management arrangements;
 - A Minimum Revenue Provision Policy Statement;
 - The Annual Investment Strategy;
 - The Treasury Management Policy Statement; and
 - Prudential Indicators for Treasury Management.
- 1.2 The Local Government Act 2003 requires the Authority to adopt the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities as a professional code of practice to support local authorities in taking these decisions. The Prudential regime requires consideration of the Authority's borrowing and investment strategies within the decision making process for setting the Authority's spending plans.
- 1.3 The Authority's treasury activities are strictly regulated by statutory requirements and a professional code of practice, the CIPFA Code of Practice on Treasury Management in the Public Services. The Authority has adopted this code of practice as part of its Financial Standing Orders (D 2-27.1) by resolution of the Authority. The Code of Practice was fully revised by CIPFA in 2009.
- 1.4 In 2011/12, the Authority's maximum borrowing requirement to meet new capital expenditure and debt redemptions/replacement is estimated to be £0.4 million. The borrowing strategy to meet this requirement is set out in paragraphs 2 to 5.
- 1.5 ELWA is required to prepare an Annual Minimum Revenue Provision Policy Statement setting out policy for the prudent repayment of debt. The Authority must have regard to statutory guidance issued by the Department for Communities and Local Government (DCLG) when preparing this statement. The Authority's Minimum Revenue Provision Policy Statement is set out at paragraph 6.
- 1.6 Each year the Authority is required to produce an Annual Investment Strategy that sets out the Council's policies for managing its investments. The Council's investment strategy must have regard to guidance issued by the former Office for the Deputy Prime Minister in March 2004, (now DCLG). The Annual Investment Strategy is at paragraphs 7 -11.

- 1.7 Standing Order D 2-27.6 requires that the Finance Director present to Members the Treasury Management Strategy for recommendation prior to the start of the Financial Year. The Prudential regime requires that the Prudential Indicators for Treasury Management be considered with the Treasury Management strategy and that ELWA set these limits. These are detailed at paragraph 15. This is an annual process.
- 1.8 It is a statutory requirement under Section 33 of the Local Government Act 1992 for the Authority to produce a balanced budget. In particular, an Authority is required 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, which is affordable within the projected income of the Authority for the foreseeable future.
- 1.9 Inevitably, certain technical terms have been used in this report. Explanations are provided where possible and a glossary covering main terms is included at Appendix D.

2 Borrowing Requirements and Debt Management Arrangements for 2011/12

- 2.1 ELWA's estimated total borrowing of £1,610,000 at 31st March 2011 consists entirely of Public Works Loan Board (PWLB) loans. All of these loans are on a fixed rate.
- 2.2 The current fixed borrowing rate of 9.63% is the average rate of interest payable on all loans within the portfolio. All of these loans were taken out many years ago when interest rates were much higher than now. Early repayment of these loans would incur a large premium as rates are much lower now.

3 Prospects for Interest Rates

- 3.1 As part of the Treasury Management Service Level Agreement, economic forecasting is provided and to assist the Authority to formulate a view on interest rates. The Authority's treasury management consultants Sector have provided forecasts for medium term interest rates (as at January 2011) as shown in the table below.

Annual Average %	Bank Rate	Money Market Rates		PWLB Rates*		
		3 month	1 year	10 year	25 year	50 year
2010/11	0.5	0.7	1.5	3.7	4.6	4.7
2011/12	0.7	1.0	1.8	4.5	5.3	5.3
2012/13	1.7	2.0	2.8	5.0	5.4	5.4
2013/14	3.1	3.2	3.8	5.3	5.6	5.6
2014/15	4.0	4.2	4.5	5.6	5.6	5.8
2015/16	4.0	4.2	4.2	5.4	5.5	5.5

* Borrowing Rates

- 3.2 The most recent view from Sector (January 2011) is that the strong rate of economic growth that was seen during 2010 is unlikely to be sustained. This was evidenced by the 0.5% reduction in growth in the last quarter of 2010. The danger of a double dip recession was diminishing, but the prospect of tight economic policies and weak consumer confidence coupled with the crisis in the euro-zone, means that the threat remains. The Bank of England admits that inflation will stay above target until 2012. Inflation performance remains a key risk to the future course of interest rates, however in light of the current growth figures, it is anticipated that the Monetary Policy Committee will be prepared to hold rates at very low levels until the latter stages of 2011.
- 3.3 The outlook for longer term interest rates is favourable in the short term but anticipated to deteriorate in the latter part of 2011. In the short term bond yields are likely to remain suppressed due to the continuing uncertainties and unfolding tensions within the Euro-zone. In addition, the market has been underpinned by evidence of activity in major economies and the UK Government's determination to deal with public sector finances will constrain any fall in gilt market performance in the short term. However, this will be a lengthy process and will still require heavy gilt issuance as the market will not be able to rely on Quantitative Easing indefinitely to lessen this huge burden.

4 New Borrowing Requirements

- 4.1 The Authority may need to make arrangements to finance expenditure during 2011/12 in respect of any possible capital works identified as a result of the ongoing review of landfill sites. Indicative estimates for production of Prudential Indicators are shown for 2011/12, 2012/13 and 2013/14:

Borrowing Requirement	2011/12 £'000	2012/13 £'000	2013/14 £'000
Potential Capital Spending	400	-	-
Maximum Estimated Borrowing Requirement	400	-	-

- 4.2 New Borrowing Requirements - The options available to ELWA to finance any future capital requirements include the temporary use of internal cash balances and to raise loans via PWLB and capital markets.
- 4.3 Public Works Loan Board (PWLB) - The Public Works Loan Board is a statutory body operating within the United Kingdom Debt Management Office, an executive agency of HM Treasury. Their function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect repayments. Interest rates are calculated by the Treasury and are based on base rate and the government cost of borrowing (gilt yields). Loans can be taken at fixed rates for periods up to 50 years or variable rates for up to 10 years.
- 4.4 Money Market - Institutions, such as banks, offer alternative loan arrangements to the fixed/variable rate loans offered by the Public Works Loan Board.
- 4.5 It is recommended that £400,000 is set as the borrowing requirement for 2011/12.

5 Borrowing Strategy 2011/12

- 5.1 Paragraph 4 indicates a potential need to finance £400,000 of capital requirements in 2011/12. The Authority is free to borrow what it deems to be prudent, sustainable and affordable within the Authority's approved Authorised External Debt Limit. See further detail at Para. 15.
- 5.2 The need to undertake external borrowing can be reduced by the (temporary) application of internal balances held for provisions and reserves within ELWA's accounts and cashflow movements on a day-to-day basis. The option of postponing borrowing and running down investments balances will reduce investment risk and provide some protection against low investment returns. The use of internal balances however must be monitored in order to mitigate the risks arising from the need to externally refinance when rates are unfavourable.
- 5.3 Regard must be given to the maturity profile of the loan portfolio. All borrowing undertaken will be in accordance with the objectives set out in the Authority's Treasury Management Policy Statement.
- 5.4 A view has to be taken on the balance between variable rate borrowing and fixed rate borrowing. To give ELWA maximum flexibility, it is suggested that the upper limit for fixed rate borrowing be set at 100% of its outstanding principal sums, and the upper limit for variable rate borrowing be set at 25% of its outstanding principal sums.
- 5.5 It is good practice to evaluate the borrowing portfolio on a periodic basis to see if it could be structured more efficiently. Sector, the Authority's treasury management consultants, provide information on potential restructuring opportunities as part of their service.
- 5.6 The uncertainty over the future movement of interest rates increases the risks associated with treasury activity. Therefore all borrowing options will be carefully evaluated, and advice sought where appropriate.
- 5.7 In summary, considering the factors set out above, the recommended Borrowing Strategy is:
- (a) That cash balances are used to finance capital expenditure on a temporary basis, pending permanent funding at a time when rates are deemed favourable;
 - (b) All available sources of finance are evaluated when undertaking decisions for long term borrowing and advice sought as appropriate;
 - (c) The repayment spread period of the long-term debt portfolio is set at a maximum period of 50 years;
 - (d) That the maturity schedule is maintained so that no more than 20% of total borrowing is due for renewal in any one year.
 - (e) That the upper limit for fixed rate borrowing be set at 100% and the upper limit for variable rate borrowing be set at 25%.

6 Minimum Revenue Provision

- 6.1 In accordance with the Local Government Act 2003, the Authority is required to pay off an element of accumulated General Fund capital expenditure each year through a revenue charge known as the Minimum Revenue Provision (MRP). MRP was calculated in accordance with the detailed methodology set out in the regulations. Amendment to these regulations has now replaced the detailed statutory calculation to one that Local Authorities consider to be prudent.
- 6.2 In conjunction with the regulatory amendment, the DCLG have issued statutory guidance on the “options” available for making prudent provision for the repayment of debt. These options relate to existing and supported debt, whereby the Authority receives government support towards capital financing costs, and unsupported (Prudential) borrowing whereby financing costs are met wholly by the Authority. Authorities must have regard to this guidance with effect from the 1 April 2008.
- 6.3 Secretary of State guidance requires that before the start of each financial year the Authority prepares a statement of its policy on making MRP in respect of the forthcoming financial year and submits it to Members for approval.
- 6.4 Annual Minimum Revenue Provision Statement
- (a) For capital expenditure incurred before 1 April 2008, or any new capital expenditure incurred in the future up to the limit of the Authority’s supported borrowing, minimum revenue provision will be provided for in accordance with existing practice outlined in the former regulations, which is based on a 4% charge.
 - (b) Minimum revenue provision for new capital expenditure incurred wholly or partly by unsupported (Prudential) borrowing or credit arrangements are to be determined by reference to the expected life of the asset. Asset life is deemed to begin once the asset becomes operational. Minimum revenue provision will commence from the financial year following the one in which the asset becomes operational.
 - (c) Minimum revenue provision in respect of Finance Leases and on balance sheet Private Finance Initiative (PFI) contracts will be regarded as being met by a charge equal to the element of the rent/charges that goes to write down the balance sheet liability. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off balance sheet, the minimum revenue provision requirement would be regarded as having been met by the inclusion in the charge, for the year in which the restatement occurs, of an amount equal to the write down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.
 - (d) Minimum revenue provision in respect of unsupported (Prudential) borrowing taken to meet expenditure, which is treated as capital expenditure by virtue of either a capitalisation direction or regulations, will be determined in accordance with the asset life method as recommended by the statutory guidance.

- (e) The Authority retains the right to make additional voluntary payments to reduce debt if deemed prudent.

7 Annual Investment Strategy 2011-2012

- 7.1 The Authority is required to produce an Annual Investment Strategy that sets out the Authority's policies for managing its investments. The Authority's investment strategy must have regard to the CIPFA Code of Practice on Treasury Management and the revised "Guidance on Local Government Investments" issued by the DCLG which came into operation on 1st April 2010.
- 7.2 The key intention of the Guidance is to maintain the requirement for Authorities to invest prudently, and that priority is given to the security and liquidity of investments before yield. The Guidance requires the Authority to set out within its Annual Investment Strategy:
 - (a) Security, creditworthiness criteria, risk assessment and monitoring arrangements for investments;
 - (b) The liquidity of investments and the minimum amount to be held in short-term investments (i.e. one which the Authority may require to be repaid or redeemed within 12 months of making the Investment) and those that are available to be lent for a longer period;
 - (c) Which investments the Authority may use for the prudent management of its treasury balances and limits for each class of investment;
 - (d) The classification of each investment instrument for use by either the Authority's in-house officers and/or external fund managers, and the circumstances where prior professional advice is to be sought from the Authority's treasury management advisers.

8 Investment Objectives

- 8.1 The Authority's investment strategy gives priority to:
 - (a) the security of the investments it makes;
 - (b) the liquidity of its investments to meet known liabilities.
- 8.2 The Authority's objective is therefore to achieve, within this constraint, the optimum return on its investments with the appropriate levels of security and liquidity.
- 8.3 Within the prudent management of its financial affairs, the Authority may temporarily invest funds, borrowed for the purpose of expenditure expected to incur in the reasonably near future. Borrowing purely to invest or on-lend for speculative purposes remains unlawful and the Authority will not engage in such activity.

9 Security of Capital

- 9.1 ELWA seeks to maintain the security of its investments by investing in high credit quality institutions. These institutions comprise the Authority's lending list. In order to establish the credit quality of the institutions and investment schemes in which the Authority invests, the Authority primarily makes use of credit ratings, both

country (sovereign) ratings, and institution ratings provided by the three main ratings agencies, Fitch Rating Ltd, Moody's and Standard & Poors.

- 9.2 The rating criteria are used to apply the "lowest common denominator" method, of selecting country and counterparties and applying limits. This means that the Authority's criteria will apply to the lowest available rating for any given country or institution. The major benefit of using this approach is to further enhance the risk control process of the Authority, as credit ratings are opinions, not statements of fact or a guarantee. There may be some slight differences between the ratings provided by each agency. By using the lowest set of ratings the Authority is making a conscious effort to analyse all rating information available and adopting a prudent risk-adverse policy on limits. Those institutions that have no ratings from a particular agency will still be considered as appropriate.
- 9.3 Credit Risk Assessment: As set out above, security of counterparties is evidenced by the application of minimum credit quality criteria, primarily through the use of credit ratings from the three main ratings agencies. These ratings are used to formulate a credit matrix to determine prudent investment periods and monetary limits and the need for diversification.
- 9.4 In formulating the matrix, consideration has been given to the levels of historic default against the minimum criteria used in the Authority's investment strategy. The table below, produced by Fitch Ratings, shows average defaults for differing periods of investment grade products for each long term rating category over the period 1990 to 2009.

Long Term 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%

- 9.5 The Authority's credit matrix minimum long term rating for investments up to one year is "A" and the minimum rating for investments greater than one year and up to five years is AA. The Authority's investment strategy is therefore considered low risk.
- 9.6 Other Counterparties and Investment Schemes that may be included on the approved lending list are:
- (a) Eligible institutions included in the UK Government Credit Guarantee Scheme
 - (b) Building Societies with assets in excess of £3 billion;
 - (c) AAA rated Money Market Funds;
 - (d) The UK Government (Debt Management Office and Gilts);
 - (e) UK Nationalised Banks
 - (f) Guaranteed banks with suitable Sovereign Support;

- (g) Other Local Authorities; and
- (h) Supranational Institutions.

All counterparties must meet the Authority's Creditworthiness Criteria as set out at Appendix B.

- 9.7 Credit Quality Monitoring: The Council's treasury management advisers, Sector, provide credit rating information as and when ratings change and these are acted upon when received. An institution's credit quality is reviewed before any investment is made.
- 9.8 On occasion credit ratings may be downgraded when an investment has already been made. The creditworthiness criteria used are such that minor downgrading should not affect the full receipt of the principal and interest. Any counterparty whose ratings fall to the extent that they no longer meet the approved credit quality criteria is immediately removed from the lending list. If an institution or investment scheme is upgraded so that it fulfils the Authority's criteria, its inclusion will be considered. The inclusion of institutions and investment schemes that meet the agreed credit criteria is delegated to the Finance Director.
- 9.9 Reliance is not placed on credit ratings alone. Regard is also given to other sources of information such as:
- (a) Publicity from sources such as the financial press and internet and from ratings alerts from the credit rating agencies;
 - (b) Investment rates being paid, and whether they are out of line with the market as this could indicate that the investment is of a higher risk.
 - (c) Where available, price movements of Credit Default Swaps, which are a financial instrument for swapping the risk of debt default, can be plotted to give an indicator of relative confidence about credit risk.
 - (d) All information received is acted upon promptly as appropriate.
- 9.10 Investments and Diversification across Asset Classes - Additional security of capital is also achieved through diversification and the specifying of the type of investment that the Authority is prepared to invest in.
- 9.11 "Guidance on Local Government Investments" requires the Authority to set out the investments in which it is prepared to invest under the headings of Specified Investments and Non-Specified Investments.
- 9.12 Specified Investments are those investments that meet the Authority's high credit quality as set out in this section and also meet the following criteria;
- (a) Are due to be repaid within twelve months of the date in which the investment was made;
 - (b) Are denominated in sterling and all repayments in respect of the investment are only payable in sterling;

- (c) The making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended]

Specified investments are therefore deemed to be of low risk.

- 9.13 Non-Specified Investments are all other investments that do not satisfy the Specified criteria and are deemed to have a greater potential of risk, such as investments for longer than one year or with institutions that do not have credit ratings, like some Building Societies. Limits must be set on the amounts that may be held in such investments at any one time during the year. The Authority's creditworthiness criteria for selecting non-specified investments is set out at Appendix B and Specified and Non Specified Investment categories are detailed at Appendix C.
- 9.14 Asset class limits - In accordance with current practice and the investment limits contained within the Authority's Treasury Management Practices, the maximum percentage of the portfolio which may be invested in each asset class are as follows:-

UK Government	100%
Local Authorities	100%
Banks- Specified	100%
Money Market Funds	75%
Building Societies - Specified	50%
Total Unspecified Investments	50%
Non UK Government and Supranational Bonds	15%

- 9.15 These limits have been set to ensure that the Authority retains maximum flexibility and can react quickly to changing market conditions. The actual balance between the above asset classes will depend, at any one time, on the relative levels of risk, return and the overall balance of the portfolio.

10 Investment of Cash Balances and the Liquidity of Investments

- 10.1 Cashflow Management - In order to assist in managing the Authority's finances, a cashflow model is produced. The model details all known major items of income and expenditure of both a revenue and capital nature, based on Capital and Revenue budget proposals, detailed elsewhere on your agenda. Cash balances can fluctuate significantly during the course of the year due to timing differences between the receipt of cash such as grants and capital receipts and the corresponding expenditure. It is estimated that over the course of the year cash balances will vary between £8 million and £25 million. The initial cashflow estimates provide an indication of cash receipts and outgoings on a month-by-month basis.
- 10.2 Liquidity: The Authority is required to have available, or access to adequate resources to enable it at all times to have available the level of funds which are necessary for the achievement of its service objectives. The cashflow model provides the Council with information on its cash requirements, detailing immediate cash requirements and indicates cash balances that are available for investment for longer periods. The liquidity of the investment portfolio is monitored regularly and reported at monthly treasury meetings with Senior Finance Officers. The minimum

amount of cash balances required to support cashflow management on a monthly basis is £6 million.

- 10.3 The borrowing strategy set out at paragraph 5 recommends the use of internal balances to temporarily fund capital expenditure. Whilst this will help reduce the need for investing, this must be balanced against the future requirement to replace these balances, and ensure that sufficient cash is available to meet the ELWA's liquidity requirements.
- 10.4 For debt management purposes the Authority has access to the PWLB and the money market to fund capital projects.
- 10.5 Borrowing in Advance of Need: The Authority has some flexibility to borrow funds this year for use in future years. The Finance Director may do this under delegated authority, where for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed rates will be economically beneficial to meet budgetary constraints.
- 10.6 The Finance Director will adopt a cautious approach to any such borrowing, and will only do so to fund the approved capital programme or future debt maturities where there is a clear business case. The investment of funds borrowed ahead of need, will be within the constraints of the approved investment strategy.
- 10.7 Interest Rates: As set out at paragraph 3, interest rates and therefore investment returns are expected to continue to remain low throughout the year, with the average investment return anticipated to be less than 1.5%. Low investment rates will continue to have a significant impact on investment receipts.
- 10.8 Yield - The Authority uses the 7 day LIBID rate as a benchmark for comparing the return on its investments.
- 10.9 Banking Sector/Market turbulence: Following the severe volatility in the banking sector in 2008, the Authority, like most other authorities, has taken a more cautious and prudent approach to investing by placing deposits with a more restricted lending list of Banks and Building Societies acceptable within the parameters of the overall investment strategy. This list currently comprises UK banks and building societies including those that have access to the Government's rescue package, AAA rated sterling Money Market Funds, Local Authorities and the UK Government via the Debt Management Account Deposit Facility. Investment periods have also been restricted to less than twelve months.
- 10.10 The creditworthiness criteria for choosing counterparties set out in this report provides a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve the base criteria set out in this report, under exceptional market conditions institutions can face real and sudden difficulties with a time lag before the credit rating agencies reflect this. Therefore, it is vital that the Authority maintains a strategy of responding swiftly and the Finance Director will restrict further investment activity to those counterparties that are at any one time considered of the highest credit quality. Security of the Authority's money remains the main priority and this strategy will take precedence over yield.
- 10.11 Investments Longer than a Year: The code of practice requires the Authority to give consideration to longer-term investment and set an upper limit for principal sums to

be invested for longer than one year. The Authority currently has no investments invested for longer than one year but limits must still be set to continue to accommodate these.

10.12 Having given due consideration to the level of balances over the next three years, the need for liquidity, spending commitments and provisions for contingencies, it is determined that under "normal" market conditions up to £2 million of total fund balances could be prudently invested for longer than one year.

10.13 Therefore taking all of the foregoing into consideration and to allow the Authority flexibility for market improvement, it is recommended that the Authority set an upper limit for principal sums to be invested for longer than one year at £2 million for 2011/12, £1 million for 2012/13 and £1 million for 2013/14.

11 Provision for Credit-related Losses

11.1 If any of the Authority's investments appear at risk of loss due to default, provision would need to be made from revenue for the appropriate amount. The Authority currently has no direct exposure to any banking failure, other than as set out below (para. 11.2)

11.2 An adjustment in the 2009/10 accounts was made to account for impairment of the £1 million investment to Heritable Bank. To date the Authority has received a total of £528,450 of the recoverable amount. It is currently anticipated, based on the advice from the liquidator, that on a prudent basis a total of 85p in the £ will be recovered in due course.

12 Treasury Management Consultants

12.1 Treasury Management support is provided as part of the Service Level Agreement. The Authority uses Sector as its treasury management consultants. The company provides a range of services which include:

- (a) Economic and interest rate analysis:
- (b) Credit ratings/market information service comprising the three main credit rating agencies;
- (c) Generic investment advice on interest rates, timing and investment instruments
- (d) Debt rescheduling advice;
- (e) Technical support on treasury matters and capital finance issues.

12.2 Whilst Sector provide support to the Authority's internal treasury function, under current market rules and the CIPFA Treasury Management Code of Practice, the final decision on treasury matters remains with the Authority. The treasury consultancy service is subject to regular review.

13 Member and Officer Training

13.1 One of the main requirements of the Treasury Management Code of Practice requirements is the increased Member consideration of treasury management

matters and the need to ensure officers dealing with treasury management are trained and keep their skills up to date. The Authority will address this important issue by:

- (a) Providing training sessions, briefings and reports on treasury management and investment issues to those Members responsible for the monitoring and scrutiny of treasury management, as appropriate.
- (b) Requiring all relevant Officers to keep their skills up to date by utilising both external and internal training workshops and seminars, and by participating in the CIPFA Treasury Management Forum and other relevant local groups and societies;
- (c) CIPFA and the Association of Corporate Treasurers (ACT) have jointly introduced the Certificate in Treasury Management – Public Services qualification. Treasury officers will undertake this qualification as appropriate.

14 Investment Strategy 2011/12

14.1 In summary – considering the factors set out in Paragraphs 9 and 10, the recommended Investment Strategy is:

- (a) That cash balances, not immediately required to finance expenditure, are lent to the money market for the most appropriate periods as indicated by the cashflow model and current market and economic conditions;
- (b) That liquidity is maintained by the use of overnight deposits and call funds;
- (c) That the minimum amount of short-term cash balances required to support monthly cashflow management is £6 million;
- (d) That the upper limit for investments longer than one year is £2 million;
- (e) That the maximum period for longer term lending be 5 years;
- (f) That all investment with institutions and investment schemes is undertaken in accordance with the Authority's creditworthiness criteria as set out at Appendix B;
- (g) That more cautious investment criteria are maintained during times of market uncertainty;
- (h) That all investment with institutions and investment schemes is limited to the types of investment set out under the Authority's approved "Specified" and "Non-Specified" Investments detailed in the appendix and that professional advice continues to be sought if appropriate;
- (i) That all investment is managed within the Authority's approved asset class limits as set out at paragraph 9.14.

15 Prudential Indicators for Treasury Management

15.1 Overview - The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of Authorities are affordable, prudent and sustainable. Further, that Treasury Management decisions are taken in accordance with good professional practice. To demonstrate that Authorities have fulfilled these objectives, the revised Prudential Code of Practice and revised CIPFA Treasury Management Code set out the indicators that must be used, and the factors that must be taken into account.

Prudential Indicators for Treasury Management relate to:

- (a) The adoption of the CIPFA Code of Practice for Treasury Management;
- (b) Limits for external debt;
- (c) Interest rate exposures;
- (d) Maturity structure of borrowings; and
- (e) Investment for periods of longer than one year.

15.2 The Treasury Management indicators are not targets to be aimed at, but are instead limits within which the Treasury Management policies of the Authority are deemed to be prudent.

15.3 The CIPFA Code of Practice in Treasury Management - The Authority adopted the CIPFA Code of Practice in Treasury Management in the Public Services as part of its Financial Standing Orders. In November 2009, CIPFA published a revised Code of Practice which the Authority incorporated into its Treasury Management Policies and Practices.

15.4 In accordance with the CIPFA Code of Practice in Treasury Management, the Authority has an approved Treasury Management Policy Statement. This is a short policy statement, which sets out core strategic issues and The Treasury Management Statement is reviewed periodically and amended if policies change. This Statement is attached as Appendix A for information.

15.5 Authorised limit for External Debt 2011/12 – 2013/14 - the authorised limit for external debt represents total external debt, gross of investments, and separately identifies borrowing from other long-term liabilities such PFI Schemes and Finance leasing (see paragraph 15.6). The authorised limit is based on the Authority's spending plans, makes allowance for short-term cashflow movements and provides sufficient headroom for unusual cash movements.

15.6 As part of the Prudential Indicators Members need to take account of the ELWA PFI scheme . As a result of the changes in accounting treatment PFI assets and liabilities have been brought onto the balance sheet . The liability needs to be recognised as part of the Prudential Indicators and Members need to agree to Prudential Indicators which take account of this . Of the long term liability indicator approximately £103 million relates to the PFI liability with the balance being potential finance leases which may arise as part of the International Financial Reporting Standards review.

- 15.7 In order to determine the authorised limit, a number of assumptions need to be made on the possible future use of borrowing. Borrowing can be used to finance capital expenditure over and above that supported by government grant, or to cover for slippage in the realisation of capital receipts, as an alternative form of financing e.g. instead of leasing, and for short-term treasury management purposes. Provision has also been made within the authorised limit to replace the temporary use of internal borrowing with external borrowing if rates are deemed favourable. The following table sets out limits that represent the maximum amount of gross debt:

	2011/12 £'m	2012/13 £'m	2013/14 £'m
Estimated borrowing b/f	1.6	2.0	2.0
Borrowing requirement	0.4	-	-
Replace internal borrowing	-		
Less: Maturing debt	(0.1)		(0.2)
Less: Loan Replacement			
Short term/cashflow requirements	6.0	6.5	7.0
Unforeseen cash movements	7.0	7.5	8.0
Borrowing	14.9	16.0	16.8
Other long term liabilities	105.0	105.0	105.0
Total External Debt	119.9	121.0	121.8

- 15.8 It is therefore recommended that the total Authorised Limit for External Debt for 2011/12 set at £120 million, for 2012/13 £121 million, and for 2013/14 is £122 million.
- 15.9 Operational Boundary External Debt 2011/12 – 2013/14 - as with the authorised limit for external debt, the operational boundary represents total external debt, gross of investments, and separately identifies borrowing from other long term liabilities. The operational boundary is based on the same assumptions as the authorised limit but reflects the most likely estimate, i.e. a prudent but not the worst-case scenario of gross debt, as assumed in the authorised limit. This has resulted in a reduction of £2 million that is included in the authorised debt calculation for unforeseen cash movements.
- 15.10 The operational boundary is a key monitoring tool and whilst it may be breached temporarily due to cashflow variations, a sustained or regular trend above the operational boundary would be significant and lead to further investigation and action as appropriate. It is therefore recommended that the total operational boundary for external debt for 2011/12 be set at £118 million, for 2012/13 £119 million, and for 2013/14 £120 million.

15.11 Interest rate exposure 2011/12 – 2013/14 - the management of interest rate risk is a priority for the Authority. This is recognised in the Prudential Code, which requires the Authority to establish operational boundaries on net interest rate exposure. These are set by way of two Prudential Indicators, the upper limit on fixed interest rate exposure and the upper limit on variable rate interest exposure. The indicators are calculated by netting of projected borrowing and lending estimates as follows:

	2011/12 £'000	2012/13 £'000	2013/14 £'000
Fixed Rate	8,300	8,700	8,000
Variable Rate	(25,000)	(25,000)	(25,000)

The net principal sums represent the annual upper exposure limit.

15.12 The limits indicate that all of the Authority's borrowing is fixed and interest costs are therefore certain. Investments, because they are invested mainly for less than one year, are classified as variable and income is therefore subject to movement in base rates. As cash balances fluctuate significantly throughout the year the figure for projected lending is based on the estimated maximum position.

15.13 The Authority's Treasury Management Practices require the setting of a local indicator for the percentage of borrowing at fixed and variable rates. The borrowing strategy recommends an upper limit of 100% for fixed rate borrowing, and in order to maintain flexibility should fixed term interest rates be unfavourable, that the percentage of variable rate borrowing be set at an upper limit of 25%. This would not breach the upper limit on variable rate exposure.

15.14 Maturity Structure of Borrowings – the Authority is required to set upper and lower limits with respect to the maturity structure of its fixed rate borrowings. These have been set to avoid the need to refinance a significant proportion of outstanding debt on an annual basis, and to provide the Council with flexibility to manage its debt portfolio efficiently.

	Upper Limit	Lower Limit
Under 12 months	35%	0%
12 Months and within 2 years	45%	0%
2 years and within 5 years	60%	0%
5 years and within 10 years	80%	0%
10 years and within 20 years	100%	0%
20 years and within 35 years	100%	0%
35 years to 50 years	100%	0%

15.15 Investments for longer than 364 days – within the Annual Investment Strategy, paragraph 10.13, the following amounts have been identified as available for longer term investment 2011/12 £2 million, 2012/13 £1 million and 2013/14 £1 million.

15.16 In Summary – the Prudential Indicators for Treasury Management are recommended as follows:

Authorised Limit for External Debt

	2011/12 £'m	2012/13 £'m	2013/14 £'m
Borrowing	15	16	17
Other Long Term Liabilities	105	105	105
TOTAL	120	121	122

Operational Boundary for External Debt

	2011/12 £'m	2012/13 £'m	2013/14 £'m
Borrowing	13	14	15
Other Long Term Liabilities	105	105	105
TOTAL	118	119	120

Upper Limits on Interest Rate Exposures

	2011/12 £'m	2012/13 £'m	2013/14 £'m
Fixed Rate	8.3	8.7	8.7
Variable Rate	(25.0)	(25.0)	(25.0)

Amount of Projected Fixed Rate Borrowing that is Maturing in each Period as a Percentage of Total Projected Borrowing that is Fixed Rate

	Upper Limit	Lower Limit
Under 12 months	35%	0%
12 Months and within 2 years	45%	0%
2 years and within 5 years	60%	0%
5 years and within 10 years	80%	0%
10 years and within 20 years	100%	0%
20 years and within 35 years	100%	0%
35 years to 50 years	100%	0%

Upper Limit for Total Principal Sums Invested for more than 364 days

2011/12 £'m	2012/13 £'m	2013/14 £'m
2	1	1

16 Recommendations:

16.1 It is requested that Members agree :

- (a) The Borrowing Strategy for 2011/12 as set out in Paragraphs 5 to 7;
- (b) The Minimum Revenue Provision Policy Statement for 2011/12 is set out in Paragraph 6;
- (c) The Annual investment Strategy for 2011/12 as set out in Paragraphs 9,10 and 14;
- (d) The Treasury Management Policy Statement as set out in Appendix A;
- (e) The Prudential Indicators for Treasury Management as set out in Paragraph 15.

Geoff Pearce
FINANCE DIRECTOR

Appendices	
A	Treasury Management Policy Statement
B	Creditworthiness Criteria
C	Approved List of specified and Non Specified Investments
D	Glossary
Background Papers	
None	