DERBY CITY COUNCIL

COUNCIL CABINET
19 FEBRUARY 2008

ITEM 15

Cabinet Member for Corporate Policy

Treasury Management Strategy and Prudential Code Indicators 2008/09

SUMMARY

1.1 This report sets out the Council's treasury management, ie. borrowing and investment, strategy for 2008/09, and outlines any changes that are required in the light of the external financial markets situation, new regulations and the Council's treasury management activity over the last 12 months.

1.2 Appendix 2 to this report sets out the required Prudential Indicators as required by the Prudential Code for Capital Finance. A summary of these indicators is shown at Appendix 4 and this demonstrates that the Council's capital expenditure plans are prudent and affordable. Appendix 2 also proposes changes to the Council's policy on "minimum revenue provision" for debt repayment from 2008/09, as required under draft regulations from Communities and Local Government - CLG. Final regulations are expected in March 2008.

1.3 The report also sets out in Appendix 3, the proposed Treasury Management and Annual Investment Strategy for 2008/09, taking into account the prudential indicators proposed for future years.

1.4 Appendix 3 identifies that both borrowing and investment decisions taken during 2007/08 to date have had a positive impact on the Council's finances, with investments to date earning 5.987%, outperforming the weighted average Bank of England base rate of 5.59%. Partly as a result of this performance, the treasury management budget is forecast to record an under-spend of around £3.6m in 2007/08.

RECOMMENDATIONS

Subject to any issues raised at the meeting, I support the following recommendations:

2.1 To recommend that Council approve the planned prudential indicators set out in Appendix 2 and summarised in Appendix 4.

2.2 To recommend that Council adopt the revised "minimum revenue provision" statement, in line with the draft regulations, as set out in Appendix 2.

2.3 To recommend that Council adopt the Treasury Management Strategy for 2008/09, including the revisions to the counterparty criteria, as set out in Appendix 3 to this report.

REASON FOR RECOMMENDATIONS

3.1 The CIPFA Code of Practice for Treasury Management requires that all local authorities prepare an Annual Treasury Strategy and plan in advance of a new financial year. The Local Government Act 2003 introduced the prudential capital finance system, which requires the formal adoption of this code of practice and requires in addition, the preparation of an Annual Investment strategy.

3.2 In addition, draft regulations from CLG now require local authorities to take a more active approach to providing for debt repayment, instead of providing a standard 4% annually of the total capital sum advanced. The annual provision can in some circumstances be linked to the expected life of the asset being financed.

3.3 As the headline reports in the media have claimed, the financial markets suffered from a liquidity shortage in 2007, and a number of institutions worldwide (including Northern Rock in the UK) were forced to resort to emergency borrowing facilities offered by central banks. In order to reduce our exposure to this risk, we are recommending that the Council generally tighten up its counterparty lending criteria. It is expected that this will result in slightly lower returns on the Council's investments.

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Report of the Corporate Director – Resources

Treasury Management Strategy and Prudential Code Indicators 2008/09

SUPPORTING INFORMATION

1.1 Since April 2004, Councils have been required to adopt annually the prudential indicators set out in the Prudential Code for Capital Finance in Local Authorities, as determined by the Chartered Institute of Public Finance and Accountancy – CIPFA. This is given statutory force by regulations under the Local Government Act 2003.

1.2 In addition, the Council must also approve a Treasury Management Strategy, which also incorporates the Annual Investment Strategy required under the regulations introduced with the Local Government Act 2003.

Prudential Indicators and the Treasury Management Strategy

1.3 A number of the required prudential indicators are determined within the Treasury Management Strategy, and therefore both are considered within the same report. The prudential indicators are also dependent upon the scale of the Council's capital programme for 2008/09 to 2010/11, as detailed in a separate report on this agenda.

1.4 The overriding objective of the Prudential Code is to make sure that the capital investment plans of local authorities are affordable, prudent and sustainable. This is delivered through the adoption of prudential indicators. The Council sets the indicators itself, subject only to the controls of Section 4 of the Act, which allow the Government to intervene in exceptional circumstances to set national, or individual limits for Councils. These powers are expected to remain latent so long as local authorities demonstrate that they continue to act prudently when taking borrowing and investment decisions.

1.5 The most important of the indicators, in terms of constraining capital investment decisions, are those relating to affordability. They set out the extent to which the revenue budget is funding the capital cost of borrowing and also the marginal impact of capital expenditure decisions on future levels of council taxes and rents. The ratio of net financing costs to the net revenue stream shows that the relative costs of financing general fund debt are rising. However, the ratio in 2010/11 is as expected, and therefore does not undermine the sustainability and affordability of the capital programme.

1.6 The capital programme continues to incorporate an element of unsupported borrowing met from the Treasury Management revenue budget. Previously it has been assumed that £2m a year represented an affordable overall amount of unsupported borrowing, but from 2008/09 the amount will be determined by reference to the revenue cost of the particular investments. This change is due to new regulations relating to MRP - described in paragraphs 4.4 - 4.16 in Appendix 2 below**.** In addition, there are a number of self-financing capital schemes funded from unsupported borrowing. Some of these are funded from the savings that they generate, and others are funded from previously approved service revenue budgets at no additional net cost.

1.7 Most of the proposed prudential indicators are explained in detail at Appendix 2 to this report. The exceptions are those prudential indicators that relate to treasury management, which are also referred to in Appendix 2 and explained in detail in the Treasury Management Strategy in Appendix 3. Appendix 4 provides a summary of all of the prudential indicators.

Recent Developments

1.8 Up to the present all local authorities have been required to set aside annually 4% of their applied borrowing as a provision for debt repayment, although Derby City Council has always provided a higher and more prudent amount. For 2008/09 onwards CLG has issued draft regulations which state that the repayment of new prudential borrowing undertaken by the Council must be provided for in line with the expected life of the asset it finances. This should mean that the annual revenue cost of long-term assets such as land and buildings becomes cheaper, but that the annual cost of short-term assets such as IT equipment becomes more expensive. The new policy and the recommended statement for the Council to adopt are explained in greater detail in Appendix 2.

1.9 The financial markets suffered from a severe liquidity shortage in 2007, which has continued albeit to a lesser extent into 2008. The US Federal Reserve, the European Central Bank and the Bank of England were forced to inject additional liquidity into their respective financial markets in order to support a number of institutions, including Northern Rock in the UK. This shortage meant that short-term interest rates sharply increased. While the Council gained a short-term benefit from this, we have been advised to generally tighten up our counterparty lending criteria in order to reduce our risk exposure. This will result in slightly lower returns on the Council's investments. The revised lending criteria are set out in Appendix 3.

Treasury Management Performance and Budget

1.10 The Treasury Management Strategy proposed for 2008/09 is consistent with the approach taken in previous years. It sets out details of investment and borrowing performance during 2007/08. Investment performance has compared favourably with the market, with returns over the year to date averaging 5.987%, some 0.40% higher than the weighted average Bank of England Base Rate for 2007/08 to date of 5.59%.

1.11 During 2007/08 the Council has also taken advantage of lower long-term borrowing rates whenever these have been offered by the Public Works Loan Board - PWLB. The average rate for new borrowing in the year to date is 4.559% compared with 4.303% for new borrowing in 2006/07. The Council's entire debt portfolio is now held at an average rate of 4.603% compared to a rate of 5.5% assumed by the Government to be typical of local authorities for 2008/09.

1.12 This above-average performance in both investment and borrowing, together with a higher than expected level of cash balances, allowed the Council to take advantage of the credit crisis suffered elsewhere in the financial markets. This has meant that the Treasury Management budget is now expected to report a £3.6m under-spend for 2007/08.

1.13 The performance in investment and borrowing in 2007/08 is reflected in the Treasury Management budget estimates for 2008/09 to 2010/11, which are included within the overall budget proposals put forward for adoption by Cabinet. However, the budget position is being tightened considerably over the next three years, and it is highly unlikely that the under-spend generated in 2007/08 will be repeated in future years. The Treasury Management budget now relies considerably on the size of the Council's investment portfolio, and we expect this to decrease over the next three years as the Council's accommodation strategy and other major capital investments are implemented.

For more information contact:	Ciaran Guilfoyle, Group Accountant – Technical, 01332 258464 e-mail ciaran.guilfoyle@derby.gov.uk
Background papers:	The Prudential Code for Capital Finance in Local Authorities, CIPFA Draft Regulations – Local Authorities Capital Finance and Accounting Amendment (England), CLG
List of appendices:	Appendix 1 - Implications Appendix 2 - Prudential Indicators Appendix 3 - Treasury Management Strategy 2008/09 Appendix 4 - Prudential Indicator Summary 2008/09

IMPLICATIONS

Financial

1. As detailed in the report.

Legal

2. The Council is obliged to set and review prudential indicators in order to comply with the Local Government Act 2003. Unless the Government uses its powers under Section 4 of that act, the Council is free to set any reasonable indicators consistent with its other policies.

Personnel

3. None.

Equalities impact

4. None.

Corporate objectives and priorities for change

5. The objectives of the Council's Treasury Management Strategy contribute to providing excellent and value-for-money services to the citizens of Derby.

APPENDIX 2

Prudential Indicators 2008/09

The required indicators are grouped as follows:

1. Plans for capital expenditure
2. Borrowing Limits
3. Prudence
4. Affordability
5. Treasury Management

They have to be set with regard to the following:

- Affordability – for example, the effect on the Council Tax.
- Prudence and sustainability – for example, the implications for external borrowing of the plans.
- Value for money – for example, through option appraisal.
- Stewardship of assets – for example, through asset management planning.
- Service objectives – for example, through strategic planning processes.
- Practicality – for example, the achievability of the forward plan.

The proposed figures are then summarised in Appendix 4.

1. Plans for Capital Expenditure

1.1 The plans for capital expenditure must be consistent with the Council's capital programme for 2008/09 to 2010/11, which the Council will be asked to approve on 3 March 2008. The figures included in this report are based on the recommendations to this Cabinet meeting. If Cabinet prior to 3 March approves any changes to the capital programme then the Treasury Management Strategy report will be further updated.

1.2 The first indicator is the plan for capital expenditure for the next three years:

	General Fund	HRA	Total
	£m	£m	£m
2006/07 (actual)	59.6	9.9	69.5
2007/08	98.8	11.1	109.9
2008/09	87.5	11.6	99.1
2009/10	82.0	10.9	92.9
2010/11	77.5	11.1	88.6

1.3 Actual capital expenditure for 2007/08 will be recorded and reported after the end of the financial year. Latest estimates are total spend of £109.9m, of which £98.8m relates the GF and £11.1m to the HRA. The actual capital expenditure for 2006/07, as reported to Cabinet in August 2007 was £69.5m, of which, £59.6m related to the GF, and £9.9m to the HRA.

2. Borrowing

Capital Financing Requirement - CFR

2.1 The CFR uses balance sheet figures to indicate the maximum amount of capital financing that should be required by the Council to finance its assets, on the best information available at the time of setting the capital programme. This increases as more resources are spent on creating or enhancing capital assets, and reduces as debt is repaid, or capital grants, revenue or usable capital receipts are applied to finance capital expenditure. Technically, the CFR is the sum of the following items on the balance sheet:

- Fixed Assets
- Deferred Charges
- Fixed Asset Restatement Account
- Capital Financing Account
- Government Grants Deferred.

In addition, any forms of credit arrangements, including finance leases, are included in the total CFR.

2.2 The table below shows the actual and expected Capital Financing Requirements to 2010/11:

	General Fund	HRA	Total
CFR at the end of:	£m	£m	£m
2006/07 (actual)	194.2	189.5	383.6
2007/08	210.9	190.5	401.4
2008/09	233.9	190.5	424.3
2009/10	265.0	190.5	455.5
2010/11	296.5	190.5	487.0

Numbers may not sum due to rounding

Authorised Limit and Operational Boundary

2.3 Section 3 of the 2003 Local Government Act imposes a duty on the Council to set a limit on how much money it can afford to borrow and to keep this under review. The *authorised limit* is an absolute limit on borrowing, and may not be exceeded. Additionally, the Council must set an *operational boundary* for borrowing. This is a level of borrowing that, if exceeded frequently, indicates a potential problem with the borrowing strategy. These targets are required to be set on a rolling three-year basis.

2.4 The Government may, under Section 4 of the 2003 Act, impose an overall limit on the borrowing of every local authority 'for national economic reasons', and/or on an individual authority 'for the purpose of ensuring that the authority does not borrow more than it can afford'. It is not anticipated that either of these provisions will be used in the near future. Should this happen, however, there would be a marked change in the ability of the Council to borrow further prudential funds. The slight risk of this outcome is one reason for continuing to borrow further funding each year as the programme develops rather than reducing cash balances.

2.5 The *operational boundary* for borrowing is set at the expected CFR for each year. As the Council aims not to borrow (including transferred debt) above the CFR this is deemed to be a sensible level.

2.6 The *authorised limit* on borrowing is also a matter for the Council to decide. For 2007/08 Cabinet approved an authorised limit of 20% above the CFR (excluding transferred debt) to provide enough headroom to accommodate additions to the capital programme relating to waste disposal or debt rescheduling exercises in which borrowing precedes repayment. For 2008/09 onwards, rather than adding 20% to the CFR, we propose maintaining an absolute amount of £70m headroom above the initial expected operational boundary, which should still be adequate to accommodate additions to the capital programme. The operational boundary will be increased at the time that a major proposal is approved, but the authorised limit cannot be changed without approval from full Council.

2.7 The proposed limits for 2008/09 onwards for approval are set out below:

Borrowing	Operational Boundary	Authorised Limit
End of financial year:	£m	£m
2007/08	408	489
2008/09	425	495
2009/10	456	526
2010/11	487	557

2.8 In addition to this limit, a separate limit is required for other long-term liabilities, for example finance leases or other forms of credit arrangements. It is the intention to minimise new long-term liabilities other than borrowing, and the limit is therefore set to reflect only existing liabilities of this type, or other such liabilities to cater for any exceptional needs.

Other long-term liabilities	Operational Boundary	Authorised Limit
End of financial year:	£m	£m
2007/08	1	1
2008/09	1	1
2009/10	1	1
2010/11	1	1

3. Prudence

3.1 The Prudential Code requires a statement that the total net external borrowing excluding any transferred debt is less than the Council's CFR. This is to ensure that overall external borrowing exposure is not excessive. The requirement of the code is that external borrowing for 2008/09 should not exceed the CFR at the end of the third year being reported, ie. 2010/11.

3.2 The figures for Derby shown below demonstrate that total net external borrowing is well below the CFR in the period to 2010/11, and that the gross position (including net transferred debt) is forecast to be below the CFR from 2008/09:

	CFR	Net External Debt	Gross External Debt
	£m	£m	£m
2007/08 (revised)	401.4	234.1	403.3
2008/09	424.3	266.5	421.0
2009/10	455.5	297.6	450.6
2010/11	487.0	364.5	480.9

4 Affordability

4.1 The affordability measures required can be regarded as the most important indicators to be used for judging whether borrowing is prudential.

4.2 Since the additional powers afforded under the 2003 Act, there has been a considerable reduction in the legal barriers to any increased level of borrowing. This has been balanced by a lack of any additional funding for any borrowing that does not fall within the levels approved by the government. This means that borrowing beyond government limits is not illegal, but has to be paid for by the Council from council tax or housing rents.

4.3 Since April 2006, only a small portion of the marginal cost of financing 'supported' capital expenditure has been funded from Formula Grant. This is due to the operation of the system of 'floors' within the grant system. Central Government has funded only 36% of the revenue cost of capital expenditure increases through the Formula Grant for 2008/09 – the remainder falls on the council tax. The affordability indicators, showing the calculation of the marginal cost of the capital programme, are shown in Appendix 4. Capital expenditure within approved limits on Housing Revenue Account services continues to be fully funded from subsidy, although the Council no longer anticipates further Supported Capital Expenditure (Revenue) - SCE(R) - for Housing on the back of GOEM's recommendation that this should cease now that the Decent Homes standard has been achieved.

4.4 By April 2008, new regulations concerning the repayment of debt are likely to be made which will require the Corporate Director of Resources to make 'prudent provision' for the repayment of debt by means of a minimum revenue provision, MRP. Such a charge effectively reduces the 'proper' accounting charge for depreciation in the accounts of the Authority in order that the Council Tax is set at an acceptable level rather than at that required in order to finance depreciation fully.

4.5 In the past, the calculation of MRP has been stipulated in great detail by the government, although it has always been stipulated that this is a minimum provision. In future, detailed guidance will be issued which we will need to consider when setting a minimum provision. The guidance will therefore continue to act as a detailed calculation of the minimum amount which should be set aside and is likely to require us to make a statement on our policy for MRP each year. It also gives a number of options with regard to different elements of debt.

4.6 For historic debt up to and including 2007/08, MRP on debts will continue to be calculated as if the old regulations continued to exist. This is known as Option 1. An alternative to this – Option 2 - is permitted for historic debt of charging on the basis of the Council's CFR. This option is not recommended, as it would require a substantial additional charge to be levied. As a result, it is proposed that the MRP for all historic debt is calculated using Option 1 – that is that general fund debts will attract a 4% reducing balance annual charge, and HRA debts will have a 0% charge.

4.7 For new debt, the relevant charge will depend on the source of funds. For government allocations – SCE(R)s – the same options as for historic debt will be available as this will continue to be the basis of the calculation of government support – at least before scaling is applied to the Formula Grant.

4.8 However, for any unsupported expenditure that requires 'prudential' borrowing by the Council, the government is concerned that the old MRP basis of a 4% reducing balance does not require the debt to be repaid over a period connected to the life of the asset. There are therefore two further options set out for the calculation of MRP relating to any new unsupported borrowing: Option 3 - a fixed asset life basis, or Option 4 - a depreciation basis.

4.9 At first glance Option 4 has a number of attractions insofar as the calculation would be similar to the initial depreciation calculation in the accounts of the Council. It is not, however, identical, as it would be required solely for the purposes of calculating the MRP and therefore would apply only to that element of a depreciation charge financed by borrowing unsupported by the government. While this would be possible to work out, there is another drawback with the approach, which could cause greater volatility in the MRP level, known as 'impairment', ie. a reduction in value. Within the calculation of depreciation, any impairment to an asset's value has to be written down to the revenue account as it occurs. Any change in asset lives for any reason would require such a charge to be made not only in the accounts as is already required, but also in the calculation of Council Tax which is currently not the case. Future impairment in the value of the element of an asset financed by unsupported borrowing is, therefore, required to be charged immediately to the Council Tax calculation. This is difficult not only to calculate, but also to anticipate in budget planning, and could be a source of considerable volatility should asset lives be materially changed in future.

4.10 Option 3 is a much simpler approach, which requires the Council to set out the period over which any particular asset shall be paid for, based on an expected asset life. While very similar to depreciation, it avoids the volatility that might be created in the event of a change to asset lives or values in the future. Essentially it requires an asset to be paid for over its expected asset life, regardless of whether the asset actually lasts for this time. It is therefore a much more predictable and stable charge to the Council Tax calculation than Option 4 and is therefore recommended for adoption by the Council. It is also very much in line with the way in which the majority of new unsupported expenditure is currently financed by the Council.

4.11 The proposal is therefore to adopt Option 1 for historic debt and new SCE(R)s, and Option 3 for new unsupported expenditure for which borrowing is required.

4.12 In order to calculate the MRP required under option 3, the Council needs to set a 'default' set of asset lives that would normally be used for a category of works. An initial list is set out below, but it is expected that this may require updating once it has been more fully reviewed by the Asset Management Group. In all cases it is the expected life of the asset being financed that is the prime factor that should be used.

Initial 'normal' asset lives:		Examples
New Land and Buildings	50 years	Schools, offices, community centres
New Infrastructure	40 years	Highways, surface car parks
Refurbishment of buildings	25 years	Highly variable – depends on scheme
Community Assets	20 years	Parks, play areas, path renewal
Car Park renewal	15 years	Multi Storey Car parks
Furniture	10 years	
Vehicles	7 years	Refuse vehicles
Contract related	– depends on contract length and nature	
ICT	3 years	Hardware and Software

4.13 The new policy will impact on the 'general' corporate unsupported borrowing that previously has been calculated at £2m a year. The annual financing cost of each item in the programme financed through borrowing will now have to be calculated individually, and it will be the derived revenue cost and not the initial capital cost that will determine the affordability of the corporate programme. These annual revenue costs will be limited to £180,000.

4.14 This could mean that the revenue budget required for Public Realm investment is reduced if the average life of assets being financed is greater than 15 years - the previous maximum asset life allowable – but increased if the life is shorter, such as for ICT investments. In any case, as the annual cost of £1m of capital expenditure now varies according to asset life the local indicator that showed the notional impact of this on the council tax has been removed from Appendix 4.

4.15 The current draft regulations suggest that the charge for principal should be equal in each year of the expected life, with interest consequently reducing each year. The Council's current policy is to charge on an annuity basis - akin to a repayment mortgage - where the same overall charge, incorporating both interest and principal, is used each year. We are hopeful that the final regulations will allow an annuity to be charged as this will remain in keeping with the Council's current policy and ensure that the early years of financing a capital scheme are not needlessly more expensive than the later years. The Council has requested that this be considered in its response to the government's consultation on this matter.

4.16 We therefore propose that the Council adopts the following MRP statement:

The Council intends make a prudent revenue provision for financing the repayment of debt on the following basis:

- <u>Historic Debts and new SCE(R)s:</u> treated under old MRP regulations - equivalent to 4% reducing balance for General Fund debts and 0% for HRA debts. [Option 1]

- <u>New Unsupported Expenditure</u>: based if permitted on an annuity – if not as an equal instalment of principal basis – over asset lives based on the default levels indicated in this report, unless otherwise determined by the Asset Management Group in agreement with the Corporate Director of Resources. [Option 3]

Spending Plans

4.17 The current proposed capital spending plans include borrowing-funded schemes as follows:

	Supported Borrowing SCE(R)	Unsupported Borrowing (Corporate)	Unsupported Borrowing (Service Financed)	Unsupported Borrowing (Spend to Save)	Total Borrowing
	£m	£m	£m	£m	£m
2007/08	11.440	10.536	2.252	0.864	25.092
2008/09	7.713	21.718	1.987	0.620	32.038
2009/10	5.593	34.531	0.281	1.000	41.405
2010/11	4.408	36.963	1.195	0.000	42.566

4.18 The first affordability indicator is the expected **ratio of financing costs to the net revenue stream.** The aim of this indicator is to measure the relative level of total debt costs in each authority. It is unaffected by the changes in Government support for capital schemes referred to above.

4.19 Direct comparisons between sectors or authorities are not very meaningful other than to measure the overall level of such debts that are held. The indicators for Derby, based on unsupported borrowing indicated above and the revisions to MRP for prudential borrowing schemes as highlighted above, are:

	General Fund	HRA
End of financial year:	%	%
2006/07 (actual)	7.05	22.43
2007/08	7.21	21.71
2008/09	8.91	20.50
2009/10	10.20	20.34
2010/11	11.46	20.92

4.20 The second affordability indicator is an estimate of the **incremental impact of capital investment decisions on the Council Tax***.* This is defined in the Prudential Code as the incremental impact of the difference between the total budgetary requirement of the Council with no changes to the existing capital programme and the total budgetary requirement of the Council with the additional programme. The 'incremental impact' is defined as the *gross* budgetary impact of borrowing, before taking into account any Government funding. This overstates the budgetary impact, as some borrowing is partly funded by Formula Grant, but it is considered to be the method most consistent with the Prudential Code, as in theory allocations of supported borrowing no longer have to be spent, meaning that all borrowing has an impact on the Council's financial position.

4.21 This indicator is calculated using the total borrowing, supported and unsupported, that is added annually to the capital programme. 'Spend to Save' schemes are excluded from the calculation as their approval is dependent on realisation of equivalent revenue savings. An interest rate of 5% is assumed for new borrowing, all of which falls on council tax, as there is no HRA unsupported borrowing planned.

4.22 In addition to financing capital expenditure from borrowing, the capital programme is also partly financed from useable capital receipts and direct charges to the revenue account. These methods also result in an impact on the revenue account. Use of capital receipts reduce the Council's balances available for investment and therefore will result in lower investment income. Capital funded by a revenue contribution has the direct impact of the amount funded.

4.23 The following table demonstrates the revenue impact of all schemes funded using these methods since the inception of prudential borrowing in 2003. The estimated cost by the end of 2007/08 is £127.76 on Band D.

	2008/09 £m	2009/10 £m	2010/11 £m
Borrowing costs (principal+interest)	10.26	13.43	16.18
Reduced interest on investments	0.99	1.21	1.46
Direct use of revenue	0.85	2.82	1.89
Impact in year	**12.10**	**17.47**	**19.53**
Assumed tax base (Band D)	69,854	70,029	70,204
Band D impact (£)	**173.28**	**249.40**	**278.14**

4.24 The Government is still providing some support for capital financing costs to local authorities in Formula Grant, even though it is no longer fully funded. The calculation above errs on the side of prudence by treating all supported borrowing as a cost and not attempting to reduce that cost by the element of grant allocated for supported borrowing – currently 36% of the costs are covered. Overall financing costs are taken into account in the Treasury Management budget within the revenue budget that will be recommended to Council on 3 March 2008, and this element of the budget is still considered to be affordable.

4.25 It is worth noting, however, that all the costs underlying the prudential indicators contained within this report have been calculated on the assumption that the new statutory provision for repayment of debt (explained in paragraphs 4.4 – 4.16 above) is based on an annuity, rather than an 'equal instalments of principal' - EIP - calculation. If an EIP basis is imposed on local authorities, then the costs in the first few years of any capital scheme could be significantly higher, despite overall costs remaining similar, and thereby impact on affordability. Equally, if the annuity basis is confirmed, it may be possible to revise the budget downwards to the extent that longer-term assets are being funded by borrowing. Once the regulations are issued, this issue will be considered further and any necessary revisions to the prudential indicators will be reported to Cabinet in 2008/09.

4.26 The third affordability indicator is **the impact on council housing rents**. The Estates Pride programme includes an estimated element of capital spending, financed by the HRA, and it is this that is the main cause of the notional cost indicated below. The real impact on rents is nil as rent policy is governed by the need for rent convergence under rent restructuring. There has therefore been no direct impact on the level of individual rents as a result.

4.27 The notional impact on council rents is therefore set out below:

	2008/09 £/wk	2009/10 £/wk	2010/11 £/wk
Notional impact on weekly rent	3.83	2.81	2.40

5. Treasury Management

5.1 The prudential indicators required for Treasury Management relate to the balance of borrowing and investments between fixed and variable interest rates, and the maturity profile of borrowing. These are intended to spread risks between types of borrowing and investment, between types of interest charged, and across borrowing periods. As in previous years, the formal indicator has been supplemented by local indicators for borrowing and lending separately, in order to aid clarity. The following indicators are proposed for 2008/09:

Net exposure to interest rates:

	Upper Limit % of principal	Lower Limit % of principal
Fixed rate	120	80
Variable rate	20	-20

The figures of 120% to –20% are to cater for a situation where the Council has no variable rate borrowing but holds some variable rate investments.

5.2 The supplementary local indicators are:

	Upper Limit % of principal	Lower Limit % of principal
Long-term borrowing**:**		
Fixed rate	100	80
Variable rate	20	0
Lending:		
Fixed rate	100	30
Variable rate	70	0

All these indicators are unchanged from 2007/08.

5.3 Overall Maturity Structure of Long Term borrowing:

	Upper Limit %	Lower Limit %
Under a year	15	0
> 1 year and < 2 years	15	0
> 2 years and < 5 years	45	0
> 5 years and <10 years	75	0
> 10 years	100	25

5.4 These maturity structure indicators aim to spread the balance of the future maturity of loans as widely as possible, and avoid excessive repayments in any one year.

5.5 The Prudential Code also requires authorities to set a limit on non-specified investments. Non-specified investments tend to be of higher risk than specified investments, and are categorised as follows:

- Term deposits with a maturity of greater than 1 year
- Supranational bonds with a maturity of greater than 1 year
- Gilt-edged securities with a maturity of greater than 1 year
- Building Societies without a credit rating
- Any non-rated subsidiary of a credit-rated institution
- Share capital or loan capital in a corporate body

5.6 The only items on this list approved within the Treasury Management Strategy are:

- term deposits.
- non-credit-rated building societies.

The limits for term deposits greater than 1 year is currently £45m (which includes a maximum of £20m with approved but non-rated counterparties) and greater than 2 years is £25m. It is recommended that these be lowered to £30m and £20m respectively. As previously approved by Council, no investments will be made for a period of more than 3 years.

5.7 All these indicators are discussed more fully in the Treasury Management Strategy at Appendix 3, wherein it is recommended that the criteria for all the Council's investments be tightened up in light of the recent problems in the financial market and the possibility of financial institutions defaulting on repayments.

APPENDIX 3

Treasury Management Strategy 2008/09

Including Annual Investment Strategy

1. SUMMARY

1.1 The Council is required to adopt a Treasury Management Strategy under the CIPFA Code of Practice for Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

1.2 The Council's plans are to finance the capital programme using up to £30.4m of borrowing during 2008/09, aiming to borrow this amount at the most advantageous interest rates available during the year. If borrowing rates increase in the short term, and if there is a prospect of a decrease later, the Council has the option of running down its cash balances available for investment rather than borrowing. The precise market position will be taken into account to determine this, in consultation with our advisors.

1.3 With effect from 1 November 2007 the PWLB changed the structure of their interest rates. The PWLB reduced the length of the periods within which each interest rate applies from 5 years to 6 months. In addition, a new set of rates was introduced entitled Premature Repayment Rates. These will have the effect of reducing the ability to restructure PWLB debt. The Council will, however, continue to review, in consultation with our advisers, PWLB debt-restructuring opportunities in pursuit of cost savings, although it is clear that the extent of such opportunities will be much reduced in future as a result of these changes.

1.4 The 2003 Act requires local authorities, as part of an annual investment strategy, to identify limits for specified and non-specified investments based on an assessment of risk minimisation, return on investments, required liquidity and expenditure commitments. The situation with regard to Northern Rock and the 'credit crunch' has made it even more essential than before to place security as the main priority, and it is proposed to generally tighten up the Council's counterparty criteria. The changes are outlined in Annex 1. It is expected that doing this will result in a slightly lower rate of return on the Council's investments.

1.5 In December 2007, the Bank of England base rate was reduced to 5.50%. Our treasury management advisers are currently forecasting that that will reduce to 5.25% by March 2008, then to 5.00% by June 2008 and 4.75% by the end of September 2008. During the calendar year 2009, but not during the financial year 2008/09, it is likely to bounce back again to 5.00%. However, this forecast may change, depending on market conditions. This scenario reflects an economic slow down, moderating inflation. There are other scenarios that could evolve from the current situation. These would have differing effects on the base rate. Stagflation would see base rate reducing to 5% during the first half of 2008/09 and then returning to 5.25% by the end of 2008/09. Recession would occur if the credit crunch gets worse and asset prices collapse as fears of economic setback spreads. The effect on base rate would be that it would fall all the way down to 3.75% by the end of 2008/09. Lastly, should there be an 'Economic Rebound' the base rate would merely fall to 5.50% by the beginning of 2008/09 and then bounce back to 6% by the end of 2008/09. The general strategy toward investments is to undertake either short or long dated investments that outperform market expectations, as informed by our treasury advisors. Market rates will inevitably move during the year, and the Council will react to such changes to optimise performance within the constraints of controlling risks.

1.6 To date, performance on borrowing during 2007/08 has broadly reflected actual market movements. PWLB borrowing has been taken at an average rate of 4.56% for an average term of around 43.11 years. The average return of the investments to date of 5.987% has outperformed the weighted average Bank of England base rate of 5.59% for 2007/08 to date. However, such performance cannot be guaranteed each year, and it would be imprudent to budget on the assumption that the Council will continue to outperform the markets, although this will continue to be our aim.

2. BACKGROUND

2.1 Treasury Management is defined in the Code of Practice as:

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

2.2 These functions are carried out within a framework set by legislation. Authorities are required, under the provisions of the Local Government Act 2003, to have regard to the CIPFA prudential code for Capital Finance for borrowing and the CIPFA Treasury Management Code for investments and for the wider exercise of treasury functions generally.

2.3 It is a requirement of the CIPFA Treasury Management Code of Practise to produce Treasury Management Practices, TMPs. The Cabinet approved Derby's TMPs in November 2002. A requirement of these approved practices, endorsed by the prudential code, is the production of an annual strategy for the financial year ahead. This report seeks to identify the Council's treasury management plans for the financial year 2008/09, which have been produced in consultation with its external treasury consultants.

3. BORROWING STRATEGY

3.1 In determining Derby's borrowing strategy for 2008/09, account has been taken of:

- the latest regulatory framework
- the existing borrowing structure
- potential borrowing requirement for the year
- sources of new borrowing
- external factors influencing borrowing decisions, for example interest rate movement.

3.2 Regulatory Framework

The following key factors influence the Council's borrowing strategy:

- the Treasury Management Code of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) which took effect from April 2002

- the Local Government Act 2003, introducing the Prudential Code
- the Council's Treasury Management Practices
- the Council's planned borrowing limit, described as its Capital Financing Requirement (CFR), and determined in accordance with the Prudential Code.

3.3 Existing Borrowing Structure

As at 31 March 2008, the Council's expected level of external debt is £364.4m against an expected capital financing requirement for the same date of £401.1m. This debt consists entirely of loans from the Public Works Loan Board at a weighted average rate of 4.60%.

3.4 Borrowing during 2007/08

Date	Amount £m	Weighted Average yrs	Interest Rate %
Rescheduling			
02 August 07	58.5	47.94	4.55
24 August 07	20.0	48.04	4.50
30 October 07	38.5	42.09	4.60
Totals/Weighted Averages	**117.0**	**46.03**	**4.558**
New Borrowing			
25 May 07	4.0	25.26	4.80
11 June 07	5.0	25.22	4.90
02 August 07	5.0	47.78	4.55
23 August 07	3.8	45.72	4.45
12 October 07	4.0	42.18	4.60
27 November 07	5.0	34.88	4.48
10 December 07	2.0	34.91	4.49
10 December 07	4.0	34.52	4.49
27 December 07	3.0	49.69	4.48
07 January 08	2.0	33.69	4.41
07 January 08	2.0	44.70	4.40
28 January 08	3.0	1.18	4.32
Totals/Weighted Averages	**42.8**	**35.06**	**4.559**

The table above shows details of the replacement loans in respect of the three rescheduling exercises and the new borrowing undertaken in 2007/08. The interest rates shown broadly reflect actual market movements and compares with average PWLB rates for 20-25 year and 45-50 year loans of 4.89% and 4.62% respectively. The Council took advantage of relatively low 'current' rates during the year.

Prudential Indicators for Treasury Management

3.5 The prudential code requires the formalisation of an indicator detailing net exposure to interest rates, which is borrowing net of investments. It is proposed to retain the indicator as set for previous years, as follows:

	Upper Limit % of principal	Lower Limit % of principal
Fixed rate	120	80
Variable rate	20	-20

The figures of 120% and –20% are to cater for a situation where the Council had no variable rate borrowing, but held some variable rate investments.

3.6 To aid clarity, the official indicator is supplemented with separate local indicators for long-term borrowing. This local indicator is shown below:

	Upper Limit % of principal	Lower Limit % of principal
Long term borrowing:		
Fixed rate	100	80
Variable rate	20	0

This indicator states that no more than 20% of long-term borrowing can be taken at variable rates. For clarity, LOBO loans, which have now been repaid, are regarded as variable.

3.7 Additionally, we are required to state, in compliance with the prudential code, the planned maturity structure for long-term borrowing. The following, which follows guidance in the code and existing best practice principles of restricting any one year to 15% of the portfolio, is proposed for 2008/09:

	Upper Limit %	Lower Limit %
Under 1 year	15	0
> 1 year and < 2 years	15	0
> 2 years and < 5 years	45	0
> 5 years and < 10 years	75	0
> 10 years	100	25

This structure gives the Council considerable flexibility to pursue the best value borrowing rates depending on market. It also allows sufficient flexibility to take advantage of potential restructuring opportunities.

Borrowing Requirement

3.8 The maximum amount the authority expects to borrow over the next three years to fund planned and previous capital expenditure is currently £88.6m. This has been calculated as follows:

	08/09 £m	09/10 £m	10/11 £m
New borrowing using central government SCE(R) allocations for year	7.7	5.6	4.4
Unsupported Borrowing and Spend to Save schemes	24.3	35.8	38.2
Over/Under Borrowing b/f	-3.7	0.0	0.0
Repayment of Debt	3.1	3.1	0.1
PFI adjustment	-0.3	-0.3	-0.3
Less: earmarked for repayment of debt	-8.7	-9.9	-10.5
Potential borrowing requirement	**22.4**	**34.3**	**31.9**

Sources of Borrowing

3.9 The authority can meet its financing requirement by a combination of borrowing from external sources and/or use of funds generated internally. If the authority chooses to borrow externally, it can use either the money market or the PWLB. Historically, PWLB loan interest rates have been lower than other forms of long-term borrowing, and the authority has therefore tended to borrow from this source.

3.10 In the past, the Council has also taken decisions to borrow from the market and held £22.7m in the form of market loans of 40 years duration until this financial year. These were called in June and resulted in a decision as to whether to renew these at substantially increased interest rates or to repay immediately. As the Council had sufficient funds available at the time the option to repay, rather than incur increased interest charges, was taken, providing the opportunity to re-borrow from the PWLB as appropriate. The extension of the available term of PWLB loans during 2005/06 has removed some of the future advantage of this type of market loan and we do not expect to take further loans from the markets unless the terms are markedly better than similar PWLB loans.

3.11 Funds created internally come primarily from the amount the authority must set aside from the revenue account to meet debt repayments, known as the minimum revenue provision, or MRP. The timing of the use of these funds is left for the authority to manage.

Factors influencing borrowing decisions

3.12 The Council's treasury management advisers have produced their economic outlook and interest rate forecasts for the next financial year. Their observations are discussed below.

3.13 Current advice from our advisers is that the profile of PWLB debt is now much flatter than in previous years. As a result PWLB loans can be taken at varying lengths and not all concentrated at the longer end of the yield curve as has previously been used. There is, therefore, an opportunity to spread the maturity profile of debt repayments more evenly by spreading out the debt lengths in future, aiming to obtain best value in terms of absolute rate each time. PWLB rates are expected to continue to rise from current levels during 2008/09, but only gradually, and there is a possibility that they may well fall if the economic situation gets worse. The general policy will remain, therefore, to borrow the year's borrowing requirement, as set out in paragraph 3.8, plus an additional amount relating to the future years should advice be that interest rates appear to be towards a low point.

3.14 Any substantive reliance on variable debt should also be avoided whilst fixed rates are low, as it would leave the Council exposed to interest rate increases. The Council is in the financial position of not having to rely on any variable debt borrowing and it has been avoided and indeed reduced by the repayment of the LOBO loans. It is planned to continue this policy in 2008/09. For similar reasons, there is also a need to achieve a debt maturity profile that reduces exposure to market changes in any one year. Recommended limits are that no more than 15% of the debt portfolio should mature in any one year, which limits the use of short-dated borrowing. We are well within this limit - our highest maturity year is 2053/54 and this represents 7.14% of our overall debt.

3.15 The Council retains significant surplus cash balances, and so the option remains, as in previous years, to consider deferring borrowing and instead running down cash balances over the year. The extent to which this may occur will depend on the value considered to be available from long and medium dated borrowing. Insofar as this is an option, it will also provide flexibility over the timing of external borrowing if prevailing market investment rates are considered to be particularly low or borrowing rates are considered to be particularly high. Any decisions need to take account of the precise market position at the time, and future policy has to be both sensitive and flexible enough to react to the volatility of market sentiment.

3.16 After the changes made by the PWLB, in November 2007, options available to the Council to reschedule further long-term loans are now severely limited. The Council has, with the assistance of its advisers, been able to reschedule £117m of the existing debt of the Council and to realise considerable savings to the Treasury Management budget as a consequence. This rescheduling took place before the PWLB changed the rules. Annual savings made in this way are estimated to be approximately £0.3m. The Council's external treasury advisers will continue to provide rescheduling forecast models to determine the financial implications of repaying or replacing specific loans, which may be acted upon under delegated powers.

4. ANNUAL INVESTMENT STRATEGY

4.1 The Council, in devising its annual Investment Strategy, must have regard to Government guidance on Local Government Investments issued in 2004, which introduced the then new prudential capital finance system. Prudent investment practices are still encouraged, but without the same detailed prescriptive regulation.

4.2 This strategy satisfies the requirements of both the CIPFA Code of Practice on Treasury Management as well as Government guidance, which states that local authorities must identify the types of investment they are to use during a financial year under the headings:

- *'Specified Investments'* and
- *'Non-specified investments'*.

4.3 Specified investments refer to those investments offering higher security. The security of these deposits allows local authorities the freedom to rely on them with minimal or no procedural formalities. Non-specified investments refer to those investments that carry either a higher risk, possibly in a facility with no formal credit rating, but, often, higher liquidity, or for periods of one year or more.

4.4 This strategy sets out:

- the maximum periods for which funds should be committed.
- minimum and maximum limits (%) to be invested in each investment type.
- which investments will be classified as non-specified.
- degree of prior advice to be sought before use of non-specified investments.
- any limits on the split of fixed and variable interest rates for investments.

4.5 The Council's investment policy in previous years has been to maintain a positive short-term cash flow by using capital receipts and revenue reserves and balances to avoid the need to borrow externally for short-term purposes. It has, however, reserved the right to do so should any cash shortages arise on a day-to-day basis. This policy has worked effectively and it is proposed that this continue.

4.6 Base rates increased, from 5.25% in April 2007 to 5.50% in May 2007 and a further increase to 5.75% in July 2007. December 2007 saw the only decrease in the base rate, to 5.50%, where it remains, giving a weighted average base rate of 5.59% to date. During this period, the Council has secured an average return on external investments of 5.987%, some 40 basis points higher than the base rate weighted average. Our advisers forecast that the current base rate of 5.50% is likely to decrease to 5.25% in March 2008, 5.00% in June 2008 and 4.75% in September 2008 with a return to 5.00% in the first nine months of 2009/10. This assumes that the economy remains within their central forecast. It is normal however, for forecasts to change as market conditions change.

4.7 The Council's ability to secure a good rate of return has depended on its ability to act flexibly when market conditions suggest a particular investment is good value. The general strategy is therefore to continue to take either short or long-dated investments with the aim of outperforming market expectations, informed by the view of our treasury advisers.

4.8 Short-term cash available for investment has fluctuated between £112.3m and £172.1m so far during 2007/08 and has averaged £151.1m. It has been invested only with institutions on the Council's approved list with restrictions on overall amounts for particular institutions and sectors. These levels of available cash are likely to reduce in 2008/09, as we anticipate spending capital and revenue reserves.

4.9 Government investment guidance allows for flexibility in which investment facilities can be used. However, the Council's prime concern must still be the security of the authority's funds. When setting a limit for non-specified investments, this, together with the expected level of balances, the need for liquidity, and spending commitments over the next 3 years must be taken into account. Based on these factors, it is recommended to reduce to a maximum of £30m the amount of the Council's investment portfolio that can be prudently committed to beyond 12 months, and to £20m the amount that can be invested beyond 2 years.

4.10 It is proposed that the current approved investment criteria, including the maximum lending limits and terms for individual counterparties and sectors, are tightened considerably as a response to the events in the financial markets in the last year. This places greater emphasis on security of asset relative to the rate of return. Details of the proposed new policy are set out in Annex 1 to this strategy. The adoption of these measures is expected to result in a slightly lower rate of return on the Council's investments.

4.11 In essence, the requirements are that we will in future apply a lowest common denominator, LCD, approach. This will reduce the number of counterparties with which we are prepared to invest funds to those with the highest ratings with all three major credit rating agencies. However, the authority's lending list for specified and non-specified investments will, as usual, be continually reviewed during the year to make sure that:

- sufficient lending capacity exists to comply with limits set for fixed and variable interest rate investments.
- the authority is taking maximum advantage of all investment opportunities.
- credit rating changes are accounted for.
- liquidity is maintained.
- sufficient spread on investment counterparties and financial sectors is maintained.

4.12 Consideration will also be given to the overall level of investments when applying such limits, to ensure that the reliance on any one institution or financial sector remains in proportion to the overall portfolio.

4.13 Those investment opportunities that will be classified as Non-Specified Investments under government guidance are shown at Annex 2. It is necessary to specify in this strategy those investments that the authority feels comfortable investing in. Based on advice from our treasury consultants, the following criteria should be taken into account in making a decision on which instruments to include in the strategy:

- Certainty of no loss in the capital value of the investment
- Level of Liquidity
- Certainty of rate of return on investment
- Quality of credit rating

4.14 In the interests of minimising risk and maximising prudence, it is proposed in this investment strategy to include the following as Non-specified investment counterparties:

- Term deposits over 364 days
- Forward Deposits maturing over 364 days from the date of the deal being struck
- Unrated building societies

These facilities are secure and can be subject to stringent credit ratings. They are however, illiquid, as deposits must run their term. In addition, no investment of period greater than 12 months will be carried out without the express consent of the Corporate Director of Resources.

4.15 The following are the limits that we propose maintaining for the council's lending for 2008/09:

	Upper Limit % of principal	Lower Limit % of principal
Fixed rate	100	30
Variable rate	70	0

This is a local indicator under the Prudential Code and means that at least 30% of the Council's investments must be placed in fixed rate investments.

4.16 It is suggested that the appropriate limit for investments beyond a year be reduced as follows:

	Current	Proposed
12-24 months	£45m	£30m
24-36 months	£25m	£20m

4.17 When placing money with counterparties, the CIPFA Code of Practice for Treasury Management states that it is best practice to spread investments between brokers and direct dealing counterparties, subject to the rates offered. The Council currently uses 6 brokers:

- Tullett Prebon
- Tradition
- Sterling
- London Currency Brokers
- ICAP
- Martins

and 5 direct counterparties for Money Market Funds being:

- Barclays Global
- AIM Global
- Gartmore
- Standard Life and
- Royal Bank of Scotland.

and 2 direct counterparties for Business Reserve Accounts:

- Abbey National and
- Bank of Scotland

It is felt that these are sufficient at this time.

SPECIFIED INVESTMENTS

APPROVED ORGANISATIONS FOR INVESTMENT

No overall limit has been placed on the total level of funds placed in specified investments as a proportion of the Council's total investment portfolio, due to the low risk associated with the counterparties within this asset class. In assessing the approved organisations to be included as specified investments, the following criteria have been used:

- the security of the Council's investment with particular reference to:
- the rating of the institution for short-term investment risk (local authorities only lend for up to 364 days for specified investments)
- the rating of the institution as a 'standalone' organisation without reliance from state authorities or its owners;
- the rate of return available;
- having a sufficient spread of institutions to ensure that funds can be invested without difficulty.

Individual Institution Limits

It is proposed, in order to determine a better understanding of an institution's creditworthiness, to continue to base the selection of institutions on the 3 industry approved credit rating services, subscribed to by our treasury management consultants and widely used by many local authorities. They are Fitch, Moody's, and Standard & Poor's. These agencies rate investment counterparties according to the following criteria:

Short-term:	This relates to the expectation of investment risk and the timely repayment of principal and interest for periods up to 12 months - Top rating F1+
Long term:	This relates to investment risk and the timely payment of financial commitments of 365 days or over - Top rating AAA
Individual:	This assesses the question "if the bank were entirely independent and could not rely on support from state authorities or its owners, how would it be viewed?" - Top rating A, lowest rating E
Legal/Support:	This relates to the support that an institution might receive should it get into financial difficulty. The rating does not indicate the quality of the organisation - Top rating 1, lowest rating 5

The minimum criteria (Fitch ratings or the equivalent ratings from Moody's and Standard & Poor's) required for all institutions by Derby City Council are proposed as follows:

Short Term	Long term	Individual	Support	Max period	Limit
F1+	AA	A/B	3	3 years	£15m
F1	A	A/B	3	1 year	£10m
F1	A	C+	3	1 year	£8m
• Building Societies with assets in excess of £1bn • Derby City Council's current bank				6 months	£6m

These criteria have been considerably tightened by the introduction of a policy known as "lowest common denominator". LCD requires these levels to be achieved with *all* the ratings agencies, rather than with just one as was previously the case.

In the table above, the short and long term ratings, which indicate the counterparty's ability to continue as a going concern, are the most critical in determining the security of our investments. If the individual or the support ratings were ever substantially downgraded then it would have a 'knock on' effect on the short and long term ratings.

Our treasury advisers have stated that building societies can be considered low risk, even when they have not sought to secure a formal credit rating. Therefore, building societies that do not satisfy the minimum criteria, but which have assets in excess of £1bn, remain on the counterparty list, albeit with a reduced limit of £8m. However, the tightening of our criteria has resulted in subsidiary companies of banks being removed from the Council's list.

Overall this tightening is expected to result in slightly lower returns on the Council's investments, but the level of security on these investments will be enhanced.

Sector Limits

2007/08 sector limits, based on the existing criteria above are as follows:

Sector	Max % of portfolio
UK and Foreign Banks	70%
UK Building Societies	70%
Money Market Funds	30%

It is proposed to maintain these sector limits.

Other Facilities

Money Market Funds (sector limit of £20 million or 30% of portfolio, whichever is the higher)

	Long Term Rating	Limit
Barclays Global	AAA	Up to £15 million
AIM Global	AAA	Up to £15 million
Standard Life Investments	AAA	Up to £15 million
Gartmore	AAA	Up to £15 million
RBS Global Treasury Funds	AAA	Up to £15 million

Debt Management Account, DMA, Facility

Government run facility which, therefore, carries AAA rating and, hence, a maximum investment of £15m.

Other UK Local Authorities

Local Authorities do not have a credit rating but are considered to have a ‘notional’ AAA rating and, hence, a maximum investment of £15m.

NON-SPECIFIED INVESTMENTS

POTENTIAL INVESTMENT OPTIONS & ASSOCIATED RISK

In practice the Council has two kinds of non-specified investment:
- Investments with non-rated building societies.
- Investments in any institution that financially commit the Council for a period of greater than 12 months.

Occasionally, investments may fall into both these categories.

Investments with building societies that do not have an official credit rating are non-specified. To reflect this increased risk, a counterparty limit of £6m will apply to every building society with no credit rating, but with asset size in excess of £1bn. Higher limits apply to those with a rating as set out in Annex A. Non-rated building societies, however, are in every other way as secure as a specified investment.

The maximum limit for non-specified investments of greater than 12 months is £30m. The maximum term for any investment is 3 years. No new investments will be made with building societies without a rating over 6 months. This is a further tightening of the previous policy

The following non-specified investments are considered to be in keeping with the Council's wider Treasury Management strategy of maintaining effective control of risks whilst pursuing optimum performance consistent with those risks.

Type	Credit rated?	Benefits/Risks
Term deposits over 364 days	Yes	- Certainty of rate of return - No movement in capital Value - Illiquid - Credit risk i.e. if credit rating changes
Forward Deposits	Yes	- Certainty of rate of return - Certainty of capital value - Credit risk i.e. if credit rating changes - Cannot renege on investment - Interest rate risk
Unrated building societies	No	- Certainty of rate of return - Certainty of capital value - Potentially higher rate of return than banks

The following non-specified investments, whilst allowable under the Government's investment guidance, are not currently considered in keeping with the Council's strategy, and will be kept under review. The subsidiaries have been eliminated as they have no credit rating and we have never been able to invest for more than 3 months. Their use has been very rare in the last five years.

Type	Credit rated?	Benefits/Risks
Subsidiaries	No	- Certainty of rate of return - Certainty of capital value
Certificate of Deposit (CD) over 364 days	Yes	- Relatively liquid -Yield subject to movement during life of CD which could negatively impact on value
Callable Deposits over 364 days	Yes	- Enhanced returns compared to term deposits - Illiquid as only borrower has right to repay - Interest Rate risk if rates rise - No control over term of investment
UK Government Gilts	Govt. backed Credit quality	- Certainty of return if held to maturity - Very liquid - Potential for capital gain/loss - Redeemable within 12 months
Supranational Bonds	AAA or govt. backed	- Relatively liquid - Certainty of return if held to maturity - Potential for capital gain/loss - Redeemable within 12 months

APPENDIX 4

Prudential Code Indicators Summary 2007/08 - 2010/11

Prudential Code Reference	Indicator	Actual 2006/07	Estimated 2007/08	Estimated 2008/09	Estimated 2009/10	Estimated 2010/11
Affordability						
35-38	**Financing cost to Net Revenue Stream Ratio**					
	- General Fund %	7.05%	7.21%	8.91%	10.20%	11.46%
	- HRA %	22.43%	21.71%	20.50%	20.34%	20.92%
39	**Incremental Impact on Council Tax: Band D £/year cumulative since start of PB**	61.61	127.76	173.28	249.40	278.14
39	**Incremental Impact on Council Tax: Band D £/year year's programme**	34.95	59.05	63.99	88.32	69.06
40-41	**Incremental Impact on Housing Rents £/week - year's programme (mainly Estates Pride)**	2.30	2.63	3.83	2.81	2.40
Prudence						
45	**Actual / Forecast Borrowing compared to CFR**					
	-Net External Debt £m	232.6	234.1	266.5	297.6	364.5
	- CFR £m	383.6	401.4	424.3	455.5	487.0
Local	- Gross External Debt £m	345.0	364.4	383.7	414.9	446.6
	- CFR £m	383.6	401.4	424.3	455.5	487.0
Local	- Gross External Debt £m plus net Transferred debt	385.8	403.3	421.0	450.6	480.9
	- CFR £m	383.6	401.4	424.3	455.5	487.0
Capital Expenditure						
51-52	**Total Capital Expenditure**					
	- General Fund £m	59.6	98.8	87.5	82.0	77.5
	- HRA £m	9.9	11.1	11.6	10.9	11.1
	- Total £m	69.5	109.9	99.1	92.9	88.6
53-54	**Estimated Capital Financing Requirement**					
	- General Fund £m	194.2	210.9	233.9	265.0	296.5
	- HRA £m	189.5	190.5	190.5	190.5	190.5
	- Total £m	383.6	401.4	424.3	455.5	487.0
External Debt						
59	Authorised Limit for borrowing £m	435	489	495	526	557
	Authorised Limit for other long term liabilities £m	1	1	1	1	1
	Authorised Limit £m	436	490	496	527	558
60	Operational Boundary for borrowing £m	417	408	425	456	487
	Operational Boundary for other long term liabilities £m	1	1	1	1	1
	Operational Boundary £m	418	409	426	457	488
Treasury Management						
66	**Adopted CIPFA Treasury Management Code of Practice**	Yes	Yes	Yes	Yes	Yes
67-70	**Interest Rate Exposure - Fixed**					
	Upper limit %	95.37	120	120	120	120
	Lower limit %		80	80	80	80
67-70	**Interest Rate Exposure - Variable**					
	Upper limit %	4.63	20	20	20	20
	Lower limit %		-20	-20	-20	-20
Local	**Long term Borrowing - Fixed rate**					
	Upper limit %	93.42	100	100	100	100
	Lower limit %		80	80	80	80
Local	**Long term Borrowing - Variable rate**					
	Upper limit %	6.58	20	20	20	20
	Lower limit %		0	0	0	0
Local	**Investments - Fixed rate**					
	Upper limit %	91.16	100	100	100	100
	Lower limit %		30	30	30	30
Local	**Investments - Variable rate**					
	Upper limit %	8.84	70	70	70	70
	Lower limit %		0	0	0	0
74	**Maturity Structure of Debt - % of all debt**					
	Under a year	0.04				
	Between 1 and 2 years	7.48				
	Between 2 and 5 years	3.83				
	Between 5 and 10 years	1.02				
	Over 10 years	87.63				
77	**Investments over a year - limit £m**	£45m	£45m	£30m	£30m	£30m
Local	**Investments over two years - limit £m**	£25m	£25m	£20m	£20m	£20m
Local	**Investments with approved unrated institutions limit £m over 1 year < 2 yr**		£20m	£20m	£20m	£20m