APPENDIX A

2008/09 TREASURY MANAGEMENT STRATEGY
(Report by the Head of Financial Services)

1. INTRODUCTION

1.1 A Treasury Management Strategy ensures that the Authority has clear objectives for the management of its borrowing and investments. It is also needed to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice, which is required by the Council's Code of Financial Management. The Government has also published Guidance which recommends that an Annual Investment Strategy is produced each year and approved by the full Council.

1.2 The Guidance emphasises that priority must be given to the security and liquidity of investments whilst the Code covers the same point by requiring the effective management and control of risk. This Strategy is intended to meet the requirements of the Code and the Guidance.

1.3 When the Government removed its controls on capital expenditure levels a few years ago it introduced the concept of the Prudential Code which pulled together a number of indicators related to capital expenditure, external debt and treasury management. Its purpose was to demonstrate that the Council's capital expenditure plans were affordable and to provide a set of limits, to be complied with, and indicators to be monitored during the forthcoming year. These indicators are shown as Appendix B to the strategy.

1.4 The proposed strategy is attached as an Annex A.

2. RECOMMENDATION

2.1 Cabinet is requested to recommend to Council that it approves this Strategy including the Prudential Code Indicators.

BACKGROUND PAPERS:

Background files in Accountancy Section: Treasury Management Reports
Reports on the 2008/09 Budget and Medium Term Plan to Cabinet and Council
CIPFA's Treasury Management in the Public Services Code of Practice 2002
ODPM Guidance on Local Government Investments March 2004

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ANNEX A

TREASURY MANAGEMENT STRATEGY 2008/09

This Treasury Management Strategy is intended to meet the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice and the Government's Guidance on Local Government Investments.

GENERAL

Now that the Council only has one Fund Manager and all investments are in time deposits the treasury management function is less complex and less subject to short-term fluctuations in the financial markets. The treasury management strategy is therefore less detailed than in the past.

As a consequence the Council has reduced the support that it will need from its professional advisor and, although Members of the Capital Receipts Advisory Group will be kept informed of progress and any significant changes, they will not need to meet so regularly.

THE COUNCIL'S FINANCIAL STRATEGY

The Council's Financial Strategy is based on the following figures for reserves and borrowing:

FORECAST	2007/ 2008 £M	2008/ 2009 £M	2009/ 2010 £M	2010/ 2011 £M	2011/ 2012 £M	2012/ 2013 £M	2013/ 2014 £M	2014/ 2015 £M	2015/ 2016 £M	2016/ 2017 £M	2017/ 2018 £M	2018/ 2019 £M
Revenue reserves	19.1	17.1	14.6	10.6	6.8	4.4	3.0	3.0	3.0	3.0	3.0	3.0
Capital Reserves	17.3	3.4										
Total reserves (EOY)**	**36.4**	**20.5**	**14.6**	**10.6**	**6.8**	**4.4**	**3.0**	**3.0**	**3.0**	**3.0**	**3.0**	**3.0**
Need to borrow												
In year	0	0	9.8	6.4	6.2	3.9	4.0	4.2	4.3	4.4	4.6	4.7
Cumulative			**9.8**	**16.2**	**22.4**	**26.3**	**30.3**	**34.5**	**38.8**	**43.2**	**47.8**	**52.5**

** excluding cash flow surpluses and specific earmarked reserves (e.g. S106 and R&R Funds)

CASH FLOW

At any moment the Authority's investments will consist of three distinct elements - cash flow, reserves and long term borrowing.

Cash flow is the day-to-day impact of managing the flow of funds into and out of the Council and is dealt with in-house. For instance, the dates on which the County Council is paid its portion of the council tax will be different to the days the money is received from those living in the District. These cash flows will sometimes leave the Council with several million pounds to borrow or invest overnight or for a few weeks.

Reserves are more stable in that there will be a definite estimate of the amount that they will reduce or increase by during the course of the year but even this will fluctuate to some extent as a result of any variation in inflation, interest rates or general under or overspending.

Long Term Borrowing in advance of need will require investment until the capital payments are expected to be made.

MANAGING THE REDUCTION IN RESERVES

The proposed budget/MTP requires the following sums to be available in the years shown below:

SUMS REQUIRED	2007/ 2008 £M	2008/ 2009 £M	2009/ 2010 £M	2010/ 2011 £M	2011/ 2012 £M	2012/ 2013 £M
Forecast sums required	**11.8**	**15.9**	**6.0**	**3.9**	**3.9**	**2.4**
Sums held by Managers						
CDCM	**31.5**					
Available for return by EOY	7.0	14.5	5.0	2.0	3.0	0
Required	3.8	3.9	6.0	3.9	3.9	2.4
In-house	**20.0**					
Available for return by EOY	8.0	12.0	0	0	0	0
Required	8.0	12.0	0	0	0	0

Thus the mandates and consequent investment decisions need to ensure the above sums are available, together with allowance for other funding (e.g. S106), when needed.

The overall position will remain volatile, necessitating daily review to ensure that as each investment comes to its end it is, where possible reinvested for the most advantageous period based on the latest financial projections. Any advance long term borrowing will have a significant impact on this plan.

LONG TERM BORROWING

Although borrowing is not required until 2009/10 to fund the Capital Programme, effective treasury management involves borrowing when interest rates are judged to be at the optimum level, even if the funds have then to be invested until the money is required; borrowing in this way is allowed if it is for planned capital expenditure. The definition of planned expenditure is not precise and has therefore been discussed with our external auditor who is comfortable with the interpretation of it being included in our approved MTP. Hence, once Council has approved the MTP in February the figure will be £26.3M.

The borrowing strategy includes the need to spread risk, so that the Council is never left with a high proportion of its debt becoming repayable at a single time or even in the same period of an interest rate cycle. When the Council borrows the repayment profile of the debt will need to be considered though this is not critical if the borrowing is from the Public Works Loans Board (PWLB) which is a Government Agency providing funds to government bodies at wholesale market rates. This is because they allow a borrower to reschedule their debt during the course of the loan based on a prescribed formula. The combination of these wholesale rates and the option to reschedule means that local authority borrowing is frequently from the PWLB though commercial bodies are becoming more involved in this market.

Interest rates have been monitored for over a year but to date they have not been deemed to be low enough to justify early borrowing, however if rates become attractive some early borrowing can take place.

CATEGORIES OF INVESTMENT

The guidance on Local Authority Investments categorises investments as ‘specified’ and ‘non-specified’.

Specified investments are:

- in sterling
- due to be repaid within 12 months
- not defined as capital expenditure in the capital finance regulations 2003
- with a body that has a high credit rating or it is made with the UK Government (gilts or CDs), or a local Authority.

Non-specified investments include all other types of investment, for example corporate bonds.

The only non-specified investments that will be used will be time deposits of greater than 12 months with a body that has a high credit rating or is a local Authority. (Time deposits are for specified periods and are returned in full after that period – they are not subject to value fluctuations as with Gilts and Corporate Bonds)

IN-HOUSE MANAGEMENT

The in-house fund (at the time of writing) consists of two elements:

- £20M of time deposits as a result of the return of funds from Investec in September 2007.
- £3.8M of short term net borrowing

The second element, the fluctuating balance of the fund, is managed internally to ensure that whilst sufficient sums are available on a daily basis to meet payments to creditors the investment return is maximised on those days where a surplus is held. Because of these constant fluctuations the majority of these sums are inevitably invested for short periods as time deposits with low risk counter-parties.

Appendix A outlines the mandate for the internal funds and lists the approved counter-parties though it should be noted that these will change during the course of any year as credit ratings or size of building societies change.

The Council will need to approve a prudential indicator for the ‘authorised limit for external debt’; which combines temporary borrowing for cash flow purposes and long-term borrowing to fund capital expenditure. A maximum of £46.3m is being recommended (£20m temporary plus £26.3m long term).

MANDATE FOR CDCM

The Mandate for CDCM is shown at Appendix A.

In order to ensure the Council will have the ability to recall funds as required in future years the mandate for CDCM requires that £4.5M, £4.5M, £6.5M,

£4.5M, £4.5M and £3M are available by the end of 2007/08 and the following 5 years

ADVISORS

The Council appointed Butlers as Treasury Management Advisors to assist in the original choice of Fund Managers, develop the mandates and assist in monitoring the Managers' performance. This has been beneficial given the large sums invested, the complexity of the wider range of instruments used and the ability to compare performance with that achieved by other Fund Managers. Their contract ended in December.

It is advisable to retain an advisor to carry out the following narrower role:

- provide up-to-date information on credit ratings
- advise on borrowing and opportunities to borrow early
- provide economic data and interest rate forecasts

The service has been retendered and Sterling has been appointed for the next 3 years.

KEY POINTS

Definition of 'high credit rating' for specified investments

The Council's mandates require all investments to have a short-term rating of a minimum of F1, as defined by the credit rating agency FITCH or an equivalent rating agency

The frequency that credit ratings are monitored

Sterling monitors the credit ratings of banks and building societies and notifies your treasury management staff of any changes. Unless the Authority is notified of a variation it is assumed that the credit rating has not changed. Where a credit rating is downgraded that bank or building society will immediately be removed from the counter-party list if its new rating is outside of the defined limits.

The categories of non-specified investments that can prudently be used during 2008/09

Time deposits over 12 months.

Liquidity of investments

The time deposits managed In-house and by CDCM are non-liquid investments (i.e. they will only be available at the end of the agreed period) and their mandate specifies the dates by which sums need to be available for return. These sums will be regularly reviewed and CDCM advised of any necessary changes as the year progresses.

During 2008/09, the minimum amount that will be held in investments available for return by the end of the year will be £16.5M

Limiting Counterparty Risk

CDCM advise the Council of all proposed investments in advance. This allows the Council to ensure that the combined CDCM and In-house investment with a Counterparty does not exceed the specified limits. For example: Both lists would allow £5M with Barclays Bank but the Council will limit its investment with Barclays to £5M in total.

MANAGEMENT

The Director of Commerce and Technology and his staff, supported by the Council's professional advisor, will manage and monitor investments and borrowing. T he Capital Receipts Advisory Group will be kept informed of the situation and consulted on any significant changes to the Strategy.

The Cabinet will receive a six month report on the performance of the funds and an annual report on the performance for the year.

CHANGES TO THE STRATEGY

The strategy is not intended to be a strait-jacket but a definition of the upper limit of the level of risk that it is prudent for the Council to take in maximising its borrowing and investment activities during 2008/09. Any changes that are broadly consistent with this Strategy and either reduce or only minimally increase the level of risk, are delegated to the Head of Financial Services, after consultation with the Capital Receipts Advisory Group, where significant.

Any other proposal to change this strategy will be referred back to the Council.

PRUDENTIAL INDICATORS

The Council's Prudential Indicators are attached at Appendix C. They are based on data included in the budget report and this Strategy. They set various limits that allow officers to monitor its achievement. These indicators must be approved by the Council and can only be amended by the Council.

Appendix A

IN-HOUSE FUND MANAGEMENT

Duration of investments	£8M must be available at 31 March 2008 £12M must be available at 31 March 2009 No investment shall be longer than 3 years. *The amounts available for return in specific years will be reviewed regularly and the relevant manager informed of any changes.*
Types of investments	Fixed Deposits Deposits at call, two or seven day notice Money Market Funds No variable rate investments
Credit Ratings	F1+ by FITCH IBCA or equivalent
Maximum limits	£4m per institution or group for English and Scottish Clearing Banks and their subsidiaries, and Overseas Banks. Building Societies With assets more than £2,000m £4m With assets more than £1,000m £3m Other building societies in the top 25 £2m These totals apply to investments made up until 31 March 2009 but lower limits will be introduced for later years to avoid too high a proportion of funds being with any one counterparty.
Benchmark	LGC 7 day rate

CDCM MANDATE

Duration of investments	£4.5M must be available at 31 March 2008 £4.5M must be available at 31 March 2009 £6.5M must be available at 31 March 2010 £4.5M must be available at 31 March 2011 £4.5M must be available at 31 March 2012 £3M must be available at 31 March 2013 *The amounts available for return in specific years will be reviewed regularly and the relevant manager informed of any changes.*
Types of investments	Fixed Deposits Deposits at call, two or seven day notice Variable rate investments limited to 50% of the portfolio
Credit Ratings	F1+ by FITCH IBCA or equivalent
Maximum limits	£4m per institution or group for English and Scottish Clearing Banks and their subsidiaries, and Overseas Banks. Building Societies With assets more than £2,000m £4m With assets more than £1,000m £3m Other building societies in the top 25 £2m *These totals apply to investments made up until 31 March 2009 but lower limits will be introduced for later years to avoid too high a proportion of funds being with any one counterparty.*
Benchmark	3 month LIBID

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Appendix B

CIPFA PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES
PRUDENTIAL INDICATORS FOR 2008/09

CAPITAL EXPENDITURE

1. Actual and Estimated Capital Expenditure

	2006/7 Actual £000	2007/8 Forecast £000	2008/9 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000
Gross	**16,599**	**17,977**	**16,955**	**15,089**	**7,992**
Net	**14,837**	**13,070**	**15,472**	**14,334**	**7,497**

2. The proportion of the budget financed from government grants and council tax that is spent on interest**.**

The negative figures reflect that the Authority is a net investor and so the interest earned is used to help fund the budget.

2006/7 Actual £000	2007/8 Forecast £000	2008/9 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000
-17%	**-15%**	**-12%**	**-5%**	**-2%**

3. The impact of schemes with capital expenditure on the level of council tax

This calculation highlights the hypothetical impact on the level of Council Tax from new capital schemes that the Council has approved in the budget/MTP. It must ignore changes already approved, slippage, inflation and savings.

The actual planned change in Council Tax is different because of the impact of other variations and the use of revenue reserves.

	2008/9 Estimate	2009/10 Estimate	2010/11 Estimate
Increase	**£3.68**	**-£0.06**	**£3.06**
Cumulative	**£3.68**	**£3.62**	**£6.68**

4. The capital financing requirement**.**

This represents the need for the Authority to borrow to finance capital expenditure. Whilst the Authority has capital reserves it will not have to borrow for capital purposes but may choose to do so:

31/3/07 Actual £000	2007/8 Forecast £000	2008/9 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000	2011/12 Estimate £000	2012/13 Estimate £000
0	**0**	**0**	**9,834**	**6,397**	**6,164**	**3,909**

It totals £26.3m over the MTP period.

5. Net borrowing and the capital financing requirement**.**

Borrowing must not be used to finance revenue spending except in the short term. In the short term it is legitimately used to cover cash flow e.g. funding salaries pending receipt of council tax income or return of investments.

The forecast shows that capital reserves are expected to run out in 2009/10 and the Authority will then need to fund most of its capital expenditure from long-term borrowing. However it is permitted to borrow a certain amount in advance of the need to fund capital expenditure (see paragraph 7 below).

EXTERNAL DEBT

6. The actual external borrowing at 31 March 2007

There was no borrowing.

7. The authorised limit for external debt**.**

This is the maximum limit for borrowing and is based on a worst-case scenario. It reflects the proposed revision to the Treasury Management Strategy which allows the Authority to borrow up to £21.7m in 2007/08 and up to an aggregate of £26.3m in 2008/09 to finance capital expenditure shown as to be financed from borrowing in the Medium Term Plan period if it appears that long term rates are attractive. The remainder of the limit relates to temporary debt for Cash Flow Purposes.

	2007/8 Limit £000	2008/9 Limit £000	2009/10 Estimate £000	2010/11 Estimate £000
Short term	20,000	20,000	20,000	20,000
Long Term	21,700	26,300	30,300	34,500
Total	**41,700**	**46,300**	**50,300**	**54,500**

8. The operational boundary for external debt.

This reflects a less extreme position. Although the figure can be exceeded without further approval it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded; it allows the management of the Council's day to day cashflow. The short term and long term elements of the operational boundary will be monitored separately.

	2008/9 Limit £000	2009/10 Estimate £000	2010/11 Estimate £000
Short term	15,000	15,000	15,000
Long term	26,300	30,300	34,500
Total	**41,300**	**45,300**	**49,500**

TREASURY MANAGEMENT

9. Adoption of the CIPFA Code

The Prudential Code requires the Authority to have adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

This has been adopted.

10. Exposure to investments with fixed interest and variable interest as a percentage of total investments.

The mandates could result in a significant amount of the funds being at variable rates as CDCM has some deals where the rate is revised every quarter. In practice the exposure to variable rates is likely to be less and is effectively of a temporary nature due to the lender having an option to request repayment when rates fall.

	2008/9 Limit £000	2009/10 Estimate £000	2010/11 Estimate £000
Upper limit on fixed rate exposure	**100%**	**100%**	**100%**
Upper limit on variable rate exposure	**50%**	**50%**	**50%**

11. Borrowing Repayment Profile

The proportion of 2008/9 borrowing that will mature in successive periods.

The table refers to temporary borrowing for cash flow purposes; 100% will mature in less than 12 months. If long-term borrowing takes place it will all be for maturities in excess of ten years.

Cash flow borrowing	Upper limit	Lower limit
Under 12 months	**100%**	**100%**
12 months and within 24 months	**0%**	**0%**
24 months and within 5 years	**0%**	**0%**
5 years and within 10 years	**0%**	**0%**
10 years and above	**0%**	**0%**

Funding capital schemes	Upper limit	Lower limit
Under 12 months	**0%**	**0%**
12 months and within 24 months	**0%**	**0%**
24 months and within 5 years	**0%**	**0%**
5 years and within 10 years	**0%**	**0%**
10 years and above	**100%**	

12. Investment Repayment Profile

Limit on the value of investments that cannot be redeemed within 364 days i.e. by the end of each financial year.

	2008/9 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000
Limit on investments over 364 days as at 1 April each year.	**22,500**	**16,000**	**11,500**