OVERVIEW AND SCRUTINY ITEM, FOR CONSIDERATION PRIOR TO FULL COUNCIL

RYEDALE
DISTRICT
COUNCIL

REPORT TO:	**FULL COUNCIL**
DATE:	**21 FEBRUARY 2011**
REPORT OF THE:	**CORPORATE DIRECTOR (s151) PAUL CRESSWELL**
TITLE OF REPORT:	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2011/12**
WARDS AFFECTED:	**ALL**

EXECUTIVE SUMMARY

1.0 PURPOSE OF REPORT

1.1 To consider the Treasury Management and Annual Investment Strategies, the Minimum Revenue Provision Policy and set the Prudential Indicators for 2011/12.

2.0 RECOMMENDATIONS

2.1 It is recommended that:

(i) Members receive this report;

(ii) The Treasury Management and Investment Strategies be noted and approved by the Council.

(iii) That the Prudential Indicators (Annex E in the report) be approved by the Council.

3.0 REASON FOR RECOMMENDATIONS

3.1 The Chartered Institute of Public Finance & Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities (The Code) was adopted by the Council.

3.2 The Local Government Act 2003 and supporting regulations requires the Council to have regard to specified codes of practice, namely the CIPFA publications *Prudential Code for Capital Finance in Local Authorities* and *Treasury Management in the Public Services; Code of Practice and Cross Sectoral Guidance Notes*.

4.0 SIGNIFICANT RISKS

4.1 There are significant risks when investing public funds especially with unknown institutions. However, by the adoption of the CIPFA Code and a prudent investment policy, these are minimised. The employment of Treasury Advisors also helps reduce the risk.

REPORT

5.0 BACKGROUND AND INTRODUCTION

5.1 Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Statutory Requirements

5.2 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable and sustainable.

5.3 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included in this report).; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

5.4 The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

Balanced Budget Requirement

5.5 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital finance decisions. This therefore, means that increases in capital expenditure must be limited to a level whereby increase in charges to revenue from:

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- Any increase in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

CIPFA requirements

5.6 The CIPFA Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 10 October 2002. The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of the Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

(iii) Receipt by full Council of an annual Treasury Management Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(v) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body. For this Council the delegated body is the Overview & Scrutiny Committee.

6.0 POLICY CONTEXT

6.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in Local Authorities and this report complies with the requirements under this code and the relevant requirements of the Local Government Act 2003.

7.0 CONSULTATION

7.1 The Council use the services of Sector Treasury Services Limited to provide treasury management information and advice.

8.0 REPORT DETAILS

8.1 The Prudential Code regulates the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated Treasury Management Strategy. It requires the Council to set a number of Prudential Indicators, and these are to be considered when determining the Council's Treasury Management Strategy.

8.2 The Treasury Management Strategy Statement details the expected activities of the Treasury function in the forthcoming financial year (2011/12). Its production and submission to the Council is a requirement of the Code.

8.3 The Annual Investment Strategy will set out the Council's policies for the prudent management of its investments including the security and liquidity of those investments. It details the Specified and Non Specified Investment Instruments to be used by the Council in 2011/12. Approval is also sought for the specified use of credit ratings and the maximum periods for which funds may be prudently committed in each asset category.

8.4 The suggested strategies for 2011/12 are based upon advice from the Council's treasury advisors, Sector Treasury Services Limited (Sector).

TREASURY MANAGEMENT STRATEGY FOR 2011/12

8.5 The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser Sector Treasury Services. The strategy covers:

- Treasury limits in force which will limit the treasury risk and activities of the Council
- Current portfolio position
- The borrowing requirement
- Prudential and Treasury Indicators
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- The Minimum Revenue Provision strategy
- The investment strategy
- Creditworthiness policy
- Policy on use of external service providers

Treasury Limits for 2011/12 to 2013/14

8.6 It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

8.7 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

8.8 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in Annex E of this report.

Current Portfolio Position

8.9 The Council's treasury portfolio position at 31 December 2010 comprised:

	£'000
Investments Internally Managed:	
Temporary investments	4,870
Fixed term deposits	5,000
Investments Externally Managed:	
Fixed term deposits	5,000
Total Investments	14,870

Borrowing Requirement

8.10 The funding of the proposed 4-year Capital Plan shows that borrowing will be required. The Council's borrowing requirement is expected to be as follows:

	2009/10 Actual £'000	2010/11 Probable £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
New Borrowing	0	0	910	1,160	0
Alternative financing arrangements	0	0	0	0	0

Replacement borrowing	0	0	0	0	0
Total borrowing requirement	0	0	910	1,160	0

Prudential and Treasury Indicators for 2011/12 to 2013/14

8.11 Prudential and treasury indicators (as set out in Annex E to this report) are relevant for the purposes of setting an integrated treasury management strategy.

8.12 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted on 10 October 2002 and the revised Code was adopted by the Full Council on 22 February 2010.

Prospects for Interest Rates

The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Annex H draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view:

Sector Bank Rate forecast for financial year ends (March):
2011 0.50%
2012 1.00%
2013 2.25%
2014 3.25%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

Borrowing Strategy – Borrowing Rates

8.13 The Sector forecast for the PWLB new borrowing rate is as follows:

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	4.30%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	5.10%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%

The Council's borrowing strategy will give consideration to new borrowing in the following order of priority:

(i) The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.

(ii) Temporary borrowing from the money markets or other local authorities
(iii) PWLB variable rate loans for up to 10 years
(iv) Short dated borrowing from non PWLB below sources
(v) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
(vi) PWLB borrowing for periods under 5 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowings which will spread debt maturities away from a concentration in longer dated debt.

Borrowing Strategy – External v Internal Borrowing

8.14 The table below shows a comparison of gross and net position at the year end:

	2009/10 Actual £'000	2010/11 Probable £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Actual external borrowing (gross)	0	0	910	2,051	2,008
Cash balances	-10,724	-8,493	-4,550	-3,640	-3,435
Net borrowing	-10,724	-8,493	-3,640	-1,589	-1,427

The net position is a negative one, reflecting the fact that cash balances exceed the Council's planned borrowing for capital expenditure.

Policy on Borrowing in Advance of Need

8.15 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds. In determining whether borrowing will be undertaken in advance of need the Council will:

- Ensure the on-going revenue liabilities created, and the implications for the future plans and budgets have been considered
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- Consider the merits and demerits of alternative forms of funding
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.
- Consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the control in place to minimise them.

Minimum Revenue Provision (MRP) Policy

8.16 The Minimum Revenue Provision is the method by which an Authority charges the cost of borrowing for the purchase of capital assets to its revenue account.

8.17 The Provision is determined under guidance though Statutory Instrument 2008 no. 414. The guidance requires the policy for the calculation of MRP to be approved by Full Council.

8.18 Previously there has been no requirement for this Council to make an annual MRP as the Council was debt free and had a nil Capital Financing Requirement at the end of the previous financial year. However, the Council has a number of lease agreements that were initially entered into as operating leases but following the implementation of International Financial Reporting Standards (IFRS) is now reclassified as finance leases. As a consequence the Council will not have a nil Capital Finance Requirement in future and there will now be a need to have a MRP policy in place, which is shown in Annex B.

ANNUAL INVESTMENT STRATEGY

Investment Policy

8.19 The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:

- The security of capital and
- The liquidity of its investments

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Investment instruments identified for use in the financial year are listed in Annex F under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices schedules.

Creditworthiness Policy

8.20 This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- Credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy countries

8.21 This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands, which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service that the Council would not be able to replicate using in house resources.

8.22 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years *
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No colour not to be used

* This category has been added for AAA rated Government debt or its equivalent.

8.23 This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue preponderance to just one agency's ratings.

8.24 On-going monitoring of all credit ratings is undertaken. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

8.25 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

Country Limits

8.26 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide) The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex G. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Investment Strategy to be followed In-house

8.27 The Council's in-house managed funds are split between cash flow derived balances and £1.0m of core investments available for lending over a 1-2 year period. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

8.28 In the current economic climate it is considered appropriate to keep investments short-term and invest only with highly credit rated financial institutions. The liquidity of the Council's assets is an important consideration in view of the significant capital investment planned in the capital programme.

8.29 From time to time the fixed rate investments may span financial years. Currently the Council has 1 investment totalling £1.5m on deposit, which will mature on 12 April 2011.

External Cash Fund Management

8.30 Tradition (UK) Limited (Tradition) is a cash manager, appointed to manage, on a discretionary basis, a proportion of the Council's investment portfolio.

8.31 Currently £5m of the Council's funds is externally managed by Tradition, with 3 investments totalling £4.0m spanning financial years, which will mature between the 4 May 2011 and 11 October 2011.

8.32 The funding of the capital programme will significantly reduce the availability of balances for investment and as a consequence notice has been given to Tradition to cease the arrangement with effect from 30 June 2011. All investments after that date will be administered in-house.

End of Year Investment Report

8.33 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Policy on use of external service providers

8.34 The Council uses Sector Treasury Services as its external treasury management advisers. However, the Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

8.35 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Scheme of delegation

8.36 Please see Annex C.

Role of the section 151 officer

8.37 Please see Annex D.

9.0 IMPLICATIONS

9.1 The following implications have been identified:

a) Financial
The results of the investment strategy affect the funding of the Capital Programme.

b) Legal
There are no legal implications regarding this report.

c) Other (Equalities, Staffing, Planning, Health & Safety, Environmental, Crime & Disorder)
None to report.

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Background Papers:
None.

Background Papers are available for inspection at:
None.