FULL COUNCIL

2 FEBRUARY 2011

REPORT OF THE HEAD OF CENTRAL SERVICES

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY

1.0 PURPOSE OF REPORT

1.1 This report outlines the Council's prudential indicators for 2011/12 – 2013/14 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

(a) The reporting of the **prudential indicators** setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities – Appendix A). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;

(b) The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007 – Also Appendix A);

(c) The **treasury management strategy statement** which sets out how the Council's treasury management service will support the capital decisions taken, the day to day treasury management activity and the limitations on activity through treasury prudential indicators. The key indicator is the **Authorised Limit**, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code contained in Appendix B;

(d) The **investment strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the Department of Communities and Local Government (CLG) Investment Guidance. -See Appendix B.

The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

2.0 RECOMMENDATIONS

2.1 **The Budget and Strategic Planning Working Group recommends to the Council that:**

(a) The prudential indicators and limits as set out in Appendix A are adopted and approved;

(b) The Treasury Management Strategy and treasury management prudential indicators set out in Appendix B are adopted and approved;

(c) The Minimum Revenue Provision (MRP) Statement contained within Appendix A (paragraphs 14-16) which sets out the Council's policy on MRP is approved;

(d) **The counterparty list as set out in Appendix C be adopted and approved;**

(e) **The investment strategy contained in the treasury management strategy (Appendix B) and the detailed criteria included in Annex B1 be approved.**

3.0 KEY ISSUES

3.1 Background

3.1.1 One of the main changes in the CLG guidance introduced last year is that there is greater member scrutiny of the treasury management policies. As such Full Council in a meeting held on 3 February 2011 nominated the Budget and Strategic Planning Working Group as the responsible body to scrutinise the Treasury Management Strategy prior to approval by Full Council. Members' involvement in the process is essential in order that the Council can demonstrate that capital expenditure plans are affordable, external borrowing is prudent and sustainable and that treasury management decisions are taken in accordance with good practice.

3.1.2 To facilitate the decision making process and support capital investment decisions the Prudential Code requires the Council to agree and monitor a minimum number of prudential indicators and for housing authorities these are separated for the HRA and non-HRA capital investment. The indicators are mandatory, but can be supplemented with local indicators if this aids interpretation and many cover three years ahead.

3.1.3 The indicators cover affordability, prudence, capital expenditure, external debt and treasury management and form the basis of in year monitoring through the Members' Newsletter. For the General Fund the indicators have also been split into General and Special Expenses (Melton Mowbray).

3.1.4 The indicators are purely for internal use by the Council and are not to be used as comparators between Councils, as any comparisons will be meaningless. In addition, the indicators should not be considered individually in that the benefit from monitoring will arise from the movement in the Council's indicators over time and the year on year changes.

3.2 Treasury Management Strategy and Prudential Indicators

3.2.1 The prudential indicators are set out in Appendix A. Along with each indicator is an explanation of what it demonstrates. The indicators have been based on the position set out in the capital programme and revenue budget reports set out elsewhere on this agenda and the Medium Term Financial Strategy (MTFS) approved by the Policy, Finance & Administration Committee (PFA) on 26 January 2011.

3.2.2 The Treasury Management Strategy is attached as Appendix B including the prudential indicators that relate to the treasury management function. This strategy covers the operation of the treasury function and its activities for the forthcoming year. The strategy has been informed by advice received from the Council's treasury management consultants.

3.2.3 The Council's treasury management consultants are also advising clients to continue their counterparty selection/limit application process by using the Lowest Common Denominator (LCD) approach. The use of additional market information will be applied to compare the relative security of differing investment counterparties.

The problems encountered with key financial institutions have reinforced the need for Councils to ensure they have adopted a security based approach to their investment strategy. This approach concords with the fundamentals of local authority investing, i.e. Security first, Liquidity second and Yield, although important, third. The LCD methodology will ensure that counterparties will have to be well rated by all three rating agencies (where rated) rather than just by one or two. For example, should two of the rating agencies rate counterparty's above the threshold and one below then the institution would be excluded from the list. The Head of Central Services is responsible for preparing for the Council a list of institutions in whom the Council's funds may be invested. The following criteria define which counterparties can be used to invest surplus funds.

The institutions to be used should, as a minimum, have the following ratings:-

	FITCH RATINGS	MOODY'S RATINGS	S & P RATINGS
Rating			
Short-term	F1	P-1	A-1
Long-term	A-	A3	A-
Individual/Financial Strength	C	C	No equivalent
Potential Support	3	No equivalent	No equivalent

These ratings reflect the minimum rating for which the treasury management consultants advise acceptance of counterparties for the purpose of treasury activities. The table with the highest and lowest ratings is shown on page 3 of Appendix C.

3.2.4 For information the Council's latest updated list of approved counterparties for lending purposes is attached at Appendix C as at the date of this report. The list is updated on an ongoing basis as changes arise in an organisations credit rating. This includes the credit rating of each institution.

3.2.5 To summarise, the key issues set out in the attached appendices are as follows:

Capital Expenditure – The projected capital expenditure based on the available funding set out in the Medium Term Financial Strategy is estimated as set out in the following table:

Capital Expenditure	2010/11 Revised £000's	2011/12 Estimated £000's	2012/13 Estimated £000's	2013/14 Estimated £000's
General Expenses	5,497	2,073	260	262
Special Expenses	115	0	26	26
Total Non HRA	**5,612**	**2,073**	**286**	**288**
HRA	1,315	1,207	1,647	1,676
Total	**6,927**	**3,280**	**1,933**	**1,964**

Debt Requirement and Repayment – Part of the capital expenditure programme will be financed directly (through Government grants, capital receipts etc.), leaving a residue which will increase the Council's external borrowing requirement (its Capital Financing Requirement – CFR). The General Fund CFR is reduced each year by a statutory revenue charge for the repayment of debt known as the Minimum Revenue Provision or MRP (there is no requirement for an HRA charge). However, where unsupported borrowing is undertaken for the HRA it is considered prudent to do so.

As illustrated in Appendix A the Capital Finance and Accounting Regulations affecting MRP require the Council to formally approve a method for calculating MRP annually. For supported borrowing the existing regulatory method has been used i.e. (4% of the opening CFR for General Expenses). For new unsupported borrowing taken out in 2011/12 there are two options for calculating MRP; namely the asset life method which is currently used in terms of financial prudence and is based on the life of the particular asset or the depreciation method which ties in with the depreciation method used for the particular asset. The latter method is considered to be more complicated to calculate and also requires consideration of any residual value of the asset on disposal. It is therefore recommended that the asset life method is used for unsupported borrowing as is the case for 2010/11.

Capital Financing Requirement - The following table sets out the predicted CFR for the period 2010-2014 analysed by fund, taking into account the method of calculating MRP as recommended above.

Capital Financing Requirement	2010/11 Revised £000's	2011/12 Estimated £000's	2012/13 Estimated £000's	2013/14 Estimated £000's
General Expenses	5,584	5,347	5,124	4,923
Special Expenses	62	59	56	53
Total Non HRA	**5,646**	**5,406**	**5,180**	**4,976**
HRA	4,296	4,282	4,268	4,253
Total	**9,942**	**9,688**	**9,448**	**9,229**

The Council's anticipated net borrowing requirement (net of investments) is shown below with a comparison against the CFR. The Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2011/12 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

The Head of Central Services reports that the Council complied with this prudential indictor in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the assumptions set out in paragraph 3.2.1. The Council has in the past aimed to ensure borrowing is kept as closely aligned to the CFR as possible; however, due to the current interest rates on investments the scope for utilising internal borrowing will be considered which will mean borrowing will be for a short period below the CFR.

Net Borrowing	2010/11 Revised £000's	2011/12 Estimated £000's	2012/13 Estimated £000's	2013/14 Estimated £000's
Gross Borrowing	9,511	9,511	9,511	9,511
Investments	859	638	520	420
Net Borrowing	**8,652**	**8,873**	**8,991**	**9,091**
CFR	**9,942**	**9,688**	**9,448**	**9,229**

Against this borrowing need (the CFR), the Council's expected maximum external debt position for each year (the Operational Boundary), and the maximum amount it could borrow (the Authorised Limit) are set out as follows:

Authorised Limit & Operational Boundary	2010/11 Revised £000's	2011/12 Estimated £000's	2012/13 Estimated £000's	2013/14 Estimated £000's
Authorised limit	19,000	19,000	18,500	18,500
Operational boundary	11,732	11,700	11,200	11,200

The net revenue impact of the new capital schemes being approved as part of this budgetary cycle on Council Tax and housing rents are expected to be:

Incremental impact of capital investment decisions on:	2010/11 Revised £000's	2011/12 Estimated £000's	2012/13 Estimated £000's	2013/14 Estimated £000's
General Expenses Band D Council Tax	0.00	-0.69	-9.28	0.00
Special Expenses Band D Council Tax	0.00	0.00	0.00	0.00
Housing rents levels	0.00	0.00	0.00	0.00

4.0 POLICY AND CORPORATE IMPLICATIONS

4.1 There are no other major policy and corporate implications arising from this report.

5.0 FINANCIAL AND OTHER RESOURCE IMPLICATIONS

5.1 There are no other financial implications arising from this report.

6.0 LEGAL IMPLICATIONS/POWERS

6.1 There are no other legal implications arising from this report.

7.0 COMMUNITY SAFETY

7.1 There are no direct links to community safety arising from this report.

8.0 EQUALITIES

8.1 There are no direct equality issues arising from this report.

9.0 RISKS

9.1 The relevant risks are considered in the table below:

Probability

Very High A				
High B				
Significant C				
Low D				
Very Low E			1,2	
Almost Impossible F				
	IV Neg- ligible	III Marg- inal	II Critical	I Catast- rophic

Impact

Risk No.	Description
1	Poor Investment
2	Failure of counterparties

9.2 The relevant risks are considered to be of a very low probability, albeit of a critical nature and are mitigated as set out in the following paragraphs.

9.3 The Treasury Management Policy Statement covers limits on the amount of investments that can be held with any one institution i.e. £1m.

9.4 The Council uses three credit rating agencies to assess the suitability of lending institutions thereby reducing the reliance on just one agency. The continuation of the counterparty selection process by using the Lowest Common Denominator (LCD) approach will ensure that counterparties have to be well rated by all three rating agencies (where rated) rather than just by two. In the current environment a highly selective and cautious stance on deposit counterparties will be the best approach. This is unlikely to alter for some time to come. With this in mind in this difficult economic climate the amount deposited with the Debt Management Office – an agency of the British Government is unlimited. The problems encountered with key financial institutions have reinforced the need to ensure they have adopted a security based approach to their investment strategy. Security, liquidity and common sense will continue to override yield as prime motivators.

9.5 A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks. These benchmarks are targets and so may be breached from time to time (the benchmarks for yield are already being assessed). Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators.

10.0 CLIMATE CHANGE

10.1 There are no climate change issues arising from this report.

11.0 CONSULTATION

11.1 The Council's treasury management consultants have been consulted on this report.

12.0 WARDS AFFECTED

12.1 All wards are affected.

Contact Officer:	Dawn Garton, Head of Central Services
Date:	23 January 2011
Appendices:	The Prudential Indicators 2011/12– 2013/14 Appendix A Treasury Management Strategy 2011/12 – 2013/14 Appendix B List of Approved Counterparties for Lending Appendix C
Background Papers:	Prudential Indicators Working Papers MTFS Revenue Estimates Capital Programme
Reference:	X: Committees/Full Council/2010-11/02-02-11/DG- Prudential Indicators and Treasury Management Strategy