Agenda item 12

Cabinet – 6 February 2008

Annual Treasury Management and Investment Strategy - Prudential Indicators 2008/9 onwards

Portfolio: Councillor Al Griffiths – Finance and Personnel

Service: Corporate Finance

Wards: All

Key decisions: Yes

Forward Plan: Yes

1. Summary of report

1.1. This report sets out treasury management and investment strategies as required by the CIPFA Code of Practice and the council's investment and treasury management policy statement for 2008/9 onwards (**Appendix A**).

1.2. It also provides details on the Prudential Code Indicators (PCIs) for the next three years (**Appendix B**) and asks cabinet to recommend adoption of these to full Council. The report both complies with the Local Government Act 2003 and also provides an additional framework over and above the statutory minimum for monitoring performance in line with the council's performance management and improvement agenda.

1.3. The treasury management and investment strategies support the capital programme and revenue budgets, which in turn are key to the delivery of the council's vision. **Appendix C** provides details on the required borrowing and capital resources needed.

1.4. The treasury management function participates in a local and national benchmarking group which compares Walsall council's treasury management performance with those of other councils. In 2006/7 Walsall had the lowest average rate of borrowing (4.4%) in its family group. If we had borrowed at the average rate for all family group councils (5.7%), Walsall would have paid £2.67 million more interest than was actually paid. This has enabled the council to take out additional unsupported borrowing to support the capital programme.

2. Recommendations

2.1. That the 2008/9 treasury management and investment strategy document set out in **Appendix A** and the adoption of the prudential indicators set out in **Appendix B** be approved and recommended to Council.

2.2. That decisions to effect movements between conventional borrowing and other long term liabilities, such as leases, be delegated to the Chief Finance Officer.

2.3. That decisions to use capital receipts or unsupported borrowing within the framework of approved prudential indicators be delegated to the Chief Finance Officer.

3. Background information

3.1. Members consider treasury management and investment strategies each year as a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services; the updated version of which cabinet formally adopted on 22 March 2002. Draft regulations circulated in 2007 for consultation have included the requirement for councils to include from 1st April 2008 a minimum revenue provision (MRP) statement that highlights the policy that it intends to use in setting the amount it intends to set-aside each year for the repayment of debt (See **Appendix A**).

3.2. The 2003 Prudential Code for Capital Finance in Local Authorities (the Code) introduced new requirements for the way in which capital investment plans are considered and approved. In addition, the Code introduced more integration with councils' treasury management strategies and the council's medium term financial planning activities.

3.3. The corporate revenue budget for 2008/9 - 2012/13 contains prudential indicators and borrowing limits for treasury management activities in 2008/9. This provides a framework through which the authority's treasury management and investment strategy is monitored.

3.4. The Code requires the council to set a number of prudential indicators (PCIs) (See **Appendix B**). These effectively replace the borrowing limits and profiles that in previous years were submitted for approval, which set limits on maximum total borrowing, temporary borrowing and on the proportion of borrowing at variable interest rates. The PCIs cover a period of three years.

3.5. The ability to contain costs and make savings in this activity directly impacts on the level of resources available for the development of council strategies. Treasury management activity is delegated to the Assistant Director of Finance and Head of Corporate Finance. Relevant activities take place within the framework of the council's treasury policy statement, which sets out the type of activities that may be undertaken and by whom. It also specifies formal reporting requirements. Walsall's low average rate on its borrowing enables additional debt capacity to be used to support the capital programme.

3.6. The specific elements of the MTFS relating to treasury management are as follows:

TREASURY MANAGEMENT

CONTEXT: We have a successful track record of effective treasury management, securing low cost borrowing to fund capital investment. Our aim is to continue to do so within the requirements of the prevailing policies and codes of practice.

G1 All borrowing and/or investment activity will be carried out in accordance with the approved treasury management strategy and treasury policy statements and within approved prudential indicators, having the highest regard for prudence, affordability and sustainability in the longer term.

G2 Appropriate use will be made of the prudential Code for capital investment within approved prudential indicators and subject to medium term affordability.

Source: extract from the MTFS, Nov 2007

3.7. Noting the challenging economic outlook and the council's good track record on treasury management the local target for our external debt remains a challenging but achievable target at 4.70% including other local authority debt and 4.5% internally managed debt 2008/9. The rate to be gained from investment returns (income to the council) has been raised from 4.8% to 5.25%.

4. Resource considerations

4.1 Financial

- The council is expected to end 2007/8 with loan debt of £257m (£248m 2006/7) against an asset base of £982m and short term investments of between £70m and £80m. These will be proactively managed to minimise borrowing costs and maximise investment returns within a robust risk management environment. In 2008/9 estimated annual interest payments are c£11.2m and investment interest income c£2.5m. The net budget for capital financing in 2008/9 is £15m (£14.5m 2007/8). The challenge for the capital financing budget once again has been to manage the loss of commutation grant and discounts of £2.374m from 2006/7 whilst also generating additional borrowing capacity to support the capital programme.

- All financial activities by the council are covered by the strategies. Funds managed on behalf of schools and street lighting receive the benefit from interest gained (c£1.020m).

4.2 Legal

- The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set prudential indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable.

- borrowing and to prepare an annual investment strategy (as required by investment guidance issued subsequent to the Act); this sets out the council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

4.3 Staffing: None directly related to the report.

5. Citizen impact

None directly related to the report.

6. Community safety

None directly associated with this report.

7. Environmental impact

None directly related to the report.

8. Performance and risk management issues

8.1 Risk

Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. A risk assessment has been undertaken in determining the 2008/9 policy and this is contained within the council's corporate risk register.

8.2 Performance

- Performance is regularly reviewed by the treasury management panel. Activities are planned in 2008/9 to further improve the service and performance through the evaluation of rescheduling options and cash flow management.

- To enhance the performance monitoring of treasury activities, local indicators have also been set and are used.

9. Equality implications

None directly relating to this report.

10. Consultation

The strategies have been approved by the finance treasury management panel, an internal governance arrangement comprising the CFO (Assistant Director of Finance), Head of Corporate Finance and Corporate Financial Systems and Treasury Manager.

Background papers

Various financial working papers.
Draft Corporate Budget Plan 2008/9 – 2012/13 - Cabinet 16.01.07 & Cabinet 6.02.08
Draft Capital Programme 2008/9 – 2012/13 - Cabinet 6.02.08
Annual review of treasury management policy statement and annual report on treasury management activity for 2006/7 – Cabinet 24.10.07.
Capital Financing Environment Update - Implications to Walsall council Treasury management – Treasury Management Panel (insert date michael).

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25 January 2008

Councillor Al Griffiths
Portfolio Holder

25 January 2008

APPENDIX A

TREASURY MANAGEMENT AND INVESTMENT STRATEGIES 2008/9 ONWARDS

Walsall Council has a successful track record of effective treasury management, securing low cost borrowing to fund capital investment. Our aim is to continue to do so within the requirements of the prevailing policies and codes of practice.

In order to achieve our aim:

1. All borrowing and/or investment activity will be carried out in accordance with the approved treasury management strategy and treasury policy statements and within approved prudential indicators, having the highest regard for prudence, affordability and sustainability in the longer term.

2. Appropriate use will be made of the Code for capital investment within approved prudential indicators and subject to medium term affordability.

Specific objectives have been developed to measure and guide borrowing and investment activities. These being:

BORROWING OBJECTIVES

Our borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio
- To manage the council's debt maturity profile, ensuring no single future year has a disproportionate level of repayments
- To maintain a view on current and possible future interest rate movements and borrow accordingly
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and prudential indicators.

Specific Borrowing Objectives

- Full compliance with the Prudential Code
- Actual debt as a proportion of operational debt range is maintained at between 80%- 95%
- Average interest rate of total external debt (including other local authority debt) will be less than 4.7%
- Average maturity date between 20 and 25 years
- Capital financing costs as a percentage of the government's assumed level of Walsall's capital financing costs < 90%
- The gearing effect on capital financing estimates of 1% increase in interest rates increase must not be greater than 5%.

KEY OBJECTIVES FOR INVESTMENT

- The general policy objective for this council is the prudent investment of its treasury balances
- The council's investment priorities are:
  - The security of capital and
  - Liquidity of its investments.
- All investments will be in sterling
- The council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

Specific Investment Objectives

- Average interest rate received on short term investment to be > 5.25%
- Average interest rate received on STI Versus 7 day Libor rate – 0.1%
- Average rate on all investments >5.3%
- % daily bank balances within a target range of 98%
- A maximum of £25m is invested over a period over 365 days

ANNUAL MRP STATEMENT 2008/09

Under the Draft Local Authorities (Capital Finance and Accounting)(Amendment)(England) Regulations 2008 local authorities have a duty to produce an annual statement on its policy for making a minimum revenue provision (MRP).

For the next financial year the authority will be adopting the following policies in determining the MRP:

- For any capital expenditure carried out prior to 31 March 2008 the authority will be adopting the regulatory method (Option 1). This is where the MRP will be 4% of the opening capital financing requirement (CFR) (which has been adjusted as per the 2003 regulations).
- For any capital expenditure carried out after 1 April 2008 being financed by supported borrowing the authority will again be adopting the regulatory method (option 1).
- For any capital expenditure carried out after 1 April 2008 being financed by unsupported borrowing the authority will be adopting the asset life method (option 3). This is where MRP will be based on the capital expenditure divided by a determined asset life to give equal annual instalments. It must be noted that once the asset life has been determined for this capital expenditure it cannot be altered in future years for this repayment.

NB – This policy may be amended if the final guidance received differs from the draft guidance.

APPENDIX B

PRUDENTIAL INDICATORS FOR 2008/9, 2009/10 & 2010/11

National and local indicators that will be monitored are detailed below. Their aim is to ensure the three principles contained within the prudential code are complied with, i.e.: affordability, prudence and sustainability.

National Prudential Indicators

Table 1 details the proposed national prudential indicators for Walsall council from 2008/9 to 2010/11. More details on prudential indicators 11 and 12 are shown in table 2.

Table 1: National Prudential Indicators 2008/9 to 2009/10

No.	Indicator	2008/9	2009/10	2010/11
PCI 1	**Total capital expenditure**	**57,706**	**55,581**	**56,952**
Reduces in later years due to uncertainty on the level of future grants and other capital resources.				
PCI 2	**Estimates of the ratio of financing costs to the net revenue stream**	**8.51%**	**9.09%**	**9.42%**
Compared to other councils Walsall's is very low, most financing costs will continue to be funded from central Government. The local indicator of comparison of the unsupported financing costs to revenue stream (L3) provides more revealing and informative information on the level of costs funded from council's own resources.				
PCI 3	**Estimates of the council tax that would result from the expenditure plans.**	**6.49**	**8.76**	**3.35**
This is a notional amount indicating the amount of council tax band D that is affected by unsupported borrowing (USB).				
PCI 4	**Estimates of capital financing requirement.**	**272,073**	**280,873**	**281,200**
This represents the underlying level of borrowing needed to finance historic and future capital expenditure. To ensure that net borrowing will only fund capital, except in the short term, net external borrowing should not exceed the total capital financing requirement in the preceding year plus estimated capital financing needs for the current and next two years.				
PCI 5	**Authorised limit for external debt.**	**299,280**	**308,960**	**309,319**
The council may not breach the limit it sets, so it is important this allows prudent room for uncertain cash flow movements and borrowing in advance of future need.				
PCI 6	**Operational boundary for external debt.**	**272,073**	**280,873**	**281,200**
This has been set at the level of the capital financing requirement.				

PCI 7	**Net Borrowing exceeds Capital Financing Requirement**	**No**	**No**	**No**
The capital financing requirement (CFR) represents the underlying level of borrowing needed to finance historic capital expenditure. Actual net borrowing should be lower than this because of strong positive cash flow and balances, and it would be a cause for concern if net borrowing exceeded the CFR figure.				
PCI 8	**Compliance with CIPFA Code of Practice for TM in the Public Services.**	**Yes**	**Yes**	**Yes**
To ensure that treasury management activity is carried out within best professional practice**.**				
PCI 9	**Upper limits on fixed interest rate exposures.**	**95%**	**95%**	**95%**
The council cannot control interest rates, but a relatively high degree of interest cost stability can be achieved by limiting its exposure to variable rates and by managing the long-term debt maturity profile so that not too much fixed rate debt will mature in any year.				
PCI 10	**Upper limits on variable interest rate exposures. 3.**	**45%**	**45%**	**45%**
See comment under PCI 9.				
PCI 11	**Lower limits for the maturity structure of borrowings: 4.**	**See Table 2**		
Stability can also be managed by the long-term debt maturity profile so that not too much fixed rate debt will mature in any year.				
PCI 12	**Upper limits for the maturity structure of borrowings:**	**See Table 2**		
See comment under PCI 9.				
PCI 13	**Upper limit for principal sums invested for periods longer than 364 days.**	**£25,000,000**	**£25,000,000**	**£25,000,000**
The council is at risk when lending temporarily surplus cash. The risk is limited by investing surplus cash in specified investments and by applying lending limits and high credit worthiness. These are kept under constant review.				

Table 2 Prudential Indicators Additional Information	**2008/9**	**2009/10**	**2010/11**
PCI 11. Lower limits for the maturity structure of borrowings:			
- Under 12 Months	0%	0%	0%
- 12 months and within 24 months	0%	0%	0%
- 24 months and within 5 years	0%	0%	0%
- 5 years and within 10 years	10%	10%	10%
- 10 years and above	40%	40%	40%
PCI 12. Upper limits for the maturity structure of borrowings*:*			

- Under 12 Months	15%	15%	15%
- 12 months and within 24 months	20%	20%	20%
- 24 months and within 5 years	25%	25%	25%
- 5 years and within 10 years	50%	50%	50%
- 10 years and above	85%	85%	85%

Local Prudential Indicators

Table 3 sets out local prudential indicators proposed for 2008/9 to 2010/11.

Table 3: Local Prudential Indicators 2008/9 to 2010/11

No.	Indicator	2008/9	2009/10	2010/11
L.1	**Full compliance with Prudential Code**	**Yes**	**Yes**	**Yes**
L.2	**Average length of debt**	**20 to 25 years**	**20 to 25 years**	**20 to 25 years**
This is a maturity measure that and ideally should relate to the average lifespan of assets.				
L.3	**Ratio of unsupported financing costs to revenue stream**	**1.69%**	**2.22%**	**2.72%**
Provides an indication of the significance of USB in relation to the total net budget. A low % means that the council is using low level of own resources to fund USB.				
L.4	**Actual debt versus operational debt**	**96.0%**	**96.0%**	**96.0%**
This assists the monitoring of the authority's debt position.				
L.5	**Average interest rate of debt including OLA** **Average interest rate of debt excluding OLA**	**4.70%** **4.50%**	**4.70%** **4.50%**	**4.70%** **4.50%**
This is a recognised measure of debt management performance. The measure should be as low as possible. Other Local Authority debt (OLA) is managed on our behalf) by Dudley council				
L.6	**Gearing effect on capital financing costs of 1% increase in interest rate**	**5%**	**5%**	**5%**
This relates risk management principles to the monitoring of the TM strategy.				
L.7	**Average interest rate received on short term investment**	**5.25%**	**5.00%**	**5.00%**
A recognised PI for measuring the performance of return on investments.				
L.8	**Average interest rate received on STI Versus 30 day LIBID rate**	**0.10%**	**0.10%**	**0.10%**
This compares the interest gained on surplus funds with the 30 day LIBID rate. Measuring performance in a changing economic context. .				

L.9	**Average rate on all investments**	**5.30%**	**5.10%**	**5.10%**
As L6. but includes investments longer than 364 days.				
L.10	**% daily bank balances within target range**	**98%**	**98%**	**98%**
This measures how good our daily cash flow prediction is. A figure of 98% indicates high level of accuracy.				

The monitoring of the indicators supports budget monitoring and will be undertaken monthly and considered quarterly by the finance treasury management panel that reports to the finance service's senior management team and the Chief Finance Officer.

APPENDIX C

TREASURY LIMITS AND BORROWING LIMITS

It is a statutory duty under S.3 of the Local Government Act 2003 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 section 3 of the Local Government Act 2003.

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 and affordable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

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 indicative successive financial years.

Table 1 shows the estimate of mainstream resources from 2008/9 to 2012/2013 to support the capital programme. It shows a borrowing requirement of £61m over the next 3 years. During this period the authority plans to set aside for debt repayment, so the net increase in borrowing is expected to be £38m.

Table 1 – Estimate of Mainstream Resources 2008/9 to 2012/2013 (£M)

Borrowing Type	2008/9	2009/10	2010/11	2011/12	2012/13
Supported borrowing	7,987	6,265	4,818	4,818	4,818
Unsupported borrowing	14,972	14,157	8,269	7,241	6,335
Total borrowing	**22,960**	**20,422**	**13,087**	**12,059**	**11,154**
Capital receipts	5,050	5,300	5,000	5,000	5,000
Total	**28,010**	**25,722**	**18,087**	**17,059**	**16,154**

USE OF UNSUPPORTED BORROWING

The Prudential Code allows councils to raise finance for capital expenditure without Government consent where they can afford to service the costs of the additional debt without government support. Prior to this local authorities' capital expenditure was constrained by government borrowing approvals. Shortfalls in government funding for capital schemes were often made up by the use of capital receipts, which in some circumstances could be lost if not used. It is considered prudent however for Walsall council to have a more planned use of capital receipts over the medium term and to analyse whether it is more appropriate to use unsupported borrowing for capital programme shortfalls.

We are in a favourable position to take advantage of unsupported borrowing as:

- Compared to other councils, Walsall Council has a very low average rate on its debt - 4.69%,

- Yet the revenue settlement assumes an average borrowing rate of 5.5% in the calculation of formula grant, and
- The difference between the rate paid on new borrowing is marginally less than the interest that could be expected from an equivalent investment of capital receipts.

Therefore, it is proposed to adopt a flexible approach to funding of the 200/ capital programme by using unsupported borrowing (USB) of up to £12m as an alternative to capital receipts or where there is a related revenue stream that may be able to fund the ongoing unsupported borrowing costs. This will secure the best value for money option and optimize use of resources. For 2008/9 onwards, further use of USB is projected and included in the capital programme (see **Table 2).**

Table 2 – Unsupported Borrowing 2008/09 to 2010/11

	2008/9 £m	2009/10 £m	2010/11 £m
ICT transformation	1.787	1.869	1.344
Upper Rushall Street car park	0.350	0.000	0.000
New waste collection service	1.300	0.000	0.000
Essential maintenance of non-education premises	1.000	0.000	0.000
Debt capacity – general support	10.535	12.288	6.925
Total	**14.972**	**14.157**	**8.269**
Reserve list	1.000		

In addition to the USB allocated to specific schemes, a further £1m will be earmarked for projects that may come along throughout the year that can demonstrate with thorough option appraisal that they are self funding.

APPENDIX D

EXPLANATION OF TECHNICAL TERMS USED IN THIS REPORT AND ITS APPENDICES

TERM	DEFINITION
Authorised Limit	Level of debt set by the council that must not be exceeded.
Bond	A government or public company's document undertaking to repay borrowed money usually with a fixed rate of interest.
Borrowing	Obtaining money for temporary use that has to be repaid.
Capital receipts	The proceeds from the disposal of land or other assets. Capital receipts can be used to fund new capital expenditure but cannot be used to finance revenue expenditure
Cash flow Management	The management of the authority's receipts and payments to ensure the authority can meet its financial obligations.
Counter party limits	Maximum amount that the council may lend to other institutions will vary according to size and credit rating of other intuitions.
Credit arrangements	Are defined in section 48 of the 1989 Act – they comprise diverse forms of leases and contractual arrangements whereby authorities obtain credit other than by the borrowing of money.
Credit ceiling	The difference between the local authority's total credit liabilities in respect of capital expenditure and the provision which has been made in respect of those liabilities.
Dividends	Sum to be payable as interest on loan.
Investments	The employment of money with the aim of receiving a return.
LIBID	London Interbank Bid Rate (the rate that banks are willing to borrow from other banks)
LIBOR	London Interbank Offered Rate (the rate that banks offer to lend to other banks)
Liquidity	How easily an asset including investments may be converted to cash.
Long Term Borrowing	Borrowing of money for a term greater than one year.
Long Term Liabilities	Amounts owed by the council greater than 12 months old.
Market convention	The rules and regulations by which all brokers and dealers should abide by. It includes standards of practice and calculation convention for interest. They are defined in the London Code of Conduct ("The London Code") published by the Bank of England.
Non specified investments	Investments with a maturity exceeding a year
Operational Boundary	An indicator of the level day the authority expects during day to day treasury management activities
Other Local Authority Debt	Debt that is owed by one local authority to another local authority.
Prudential Code	A framework of policies and working practices to ensure that loc authorities' capital investment plans are affordable, prudent ar sustainable.
Short Term Borrowing	Borrowing of money for a term of up to 364 days.
Stock	Subscribed capital of trading company, or public debt of nation, municipal corporation etc regarded as transferable property
Temporary borrowing	Borrowing of money for a term of up to 364 days.
Treasury management	The management of the local authority's cash flows, its borrowings an its investments, the management of associated risks, and the pursuit the optimum performance or return consistent with those risks.

Treasury Policy Statement	A statement of key policies that an organisation follows in pursuit of effective treasury management, including borrowing limits and strateg
Variable debt	This is money that has been borrowed at a variable interest rate, and as such is subject to interest rate changes.
Unsupported borrowing	Borrowing taken through the remit of the Prudential Code for which th council will not receive any government funding and will fund from ow resources.