Agenda item 13

Cabinet – 7 February 2007

Annual Treasury Management and Investment Strategy – Prudential Indicators 2007/08 Onwards

Portfolio: Councillor John O'Hare - Resources

Service: Corporate finance

Wards: All

Key decisions: Yes

Forward Plan: Yes

Summary of report

This report presents the treasury management and investment strategies required by the CIPFA Code of Practice, the council's investment and treasury management policy statement for 2007/08 onwards and Prudential Code Indicators (PCIs) for the next three years and asks cabinet to recommend adoption to full Council.

The report complies with the Local Government Act 2003 and proposes a framework beyond the statutory minimum for monitoring performance in line with the council's performance management and improvement agenda.

Noting the challenging economic outlook and the council's good track record on treasury management, the local target for our external debt remains at 4.75% in 2007/08 but the target rate for investment returns has been raised to 4.8%.

Recommendations

1. That the 2007/08 treasury management and investment strategy document set out in **Appendix 1** and the adoption of the Prudential Indicators set out in **section E of Appendix 1** be approved and recommended to Council.

2. That decisions to effect movements between conventional borrowing and other long term liabilities (eg: leases) and decisions to use capital receipts or unsupported borrowing within the framework of approved prudential indicators be delegated to the Executive Director (CFO).

Resource and legal considerations

The council is expected to end 2006/07 with loan debt of £231m and short term investments of between £50m and £60m. These are proactively managed to minimise borrowing costs and maximise investment returns within a robust risk management environment. In 2007/08 estimated annual interest payments are c £10.3m and investment interest income c £2.5m.

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

The revenue budget for 2007/08 - 2011/12 contains PCIs and borrowing limits for treasury management activities in 2007/08. This provides a framework through which the authority's treasury management and investment strategy is monitored.

The Code requires the council to set PCIs. These replace the previous borrowing limits and profiles and set limits on maximum total borrowing, temporary borrowing and the proportion of borrowing at variable rates. PCIs cover three years and have been updated for the 2007/08 revenue budget and capital programme. The authorised limit for the council's debt has been increased to £291m. Given the rise in interest rates, the maximum amount to be invested over 12 months has been raised to £20 m and the local PCIs for investment returns have been increased to 4.8%. All council financial activities are covered by the strategies and funds managed on behalf of schools and street lighting PFI receive the benefit from interest gained (c£0.79m).

Citizen impact

None directly related to the report.

Community safety

None directly associated with this report.

Environmental impact

None directly related to the report.

Performance and risk management issues

Treasury management activity occurs within a robust risk management environment, enabling 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 2007/08 policy and this is contained within the council's corporate risk register.

The ability to contain costs and make savings in this activity directly impacts on the level of resources available to deliver council strategies. Treasury management is delegated to the Assistant Director of Finance and Head of Corporate & Strategic Finance. Relevant activities take place within the framework of the treasury policy statement, which sets out the activities that may be undertaken and by whom and formal reporting requirements.

The positioning of the treasury management strategy and policy statement within the Council's financial framework (which is embedded within the Corporate Integrated Planning & Performance Framework (CIPPF)) is illustrated below.

<table>
<tr><th colspan="6">THE FINANCIAL FRAMEWORK WITHIN THE CIPPF</th></tr>
<tr><th>CATEGORY</th><th>OVERALL</th><th>REVENUE</th><th>CAPITAL</th><th>TREASURY MANAGEMENT</th><th>RISK MANAGEMENT</th></tr>
<tr><td rowspan="2">Strategies</td><td colspan="5">MTFS</td></tr>
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<tr><td colspan="4">Contract & Finance Procedure Rules</td><td>Audit Cttee Reports & annual report</td></tr>
<tr><td colspan="5">Internal & External Audit Plans and our response to inspection and audit</td></tr>
</table>

Equality implications

None directly relating to this report.

Consultation

The strategies have been endorsed by the Finance Treasury Management Panel, an internal governance arrangement comprising the CFO, Assistant Director of Finance, Head of Corporate & Strategic Finance and Capital, Performance & Treasury Manager.

Vision 2008

The treasury management and investment strategies support the capital programme and revenue budget which are constructed to facilitate delivery of the council's vision.

Background papers

Various financial working papers; Draft Corporate Revenue Budget 2007/8 – 2011/12 - Cabinet 17.01.06; Annual review of treasury management policy statement and annual report on treasury management activity for 2005/6 – Cabinet 29.11.06.

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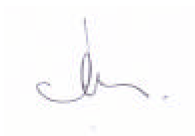
Carole Evans – Executive Director

29 January 2007

Signed:



Councillor John O'Hare – Resources

29 January 2007

APPENDIX 1

Treasury Management and Investment Strategy

CONTENTS

www.walsall.gov.uk/finance

Introduction

This is the third version of the council's treasury management and investment strategy; for many years previously the council approved a treasury management strategy in line with the CIPFA code of practice. The main objective of the strategy is to set out how the council wishes to structure and manage the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities; and the pursuit of optimum performance consistent with those risks now and in the future and to ensure this approach contributes to the delivery of the council's vision, aims and objectives.

Treasury management is part of the council's mainstream activity, and whilst this document seeks to bring together in one place the major components of the strategy, in practice elements of it are evident in a range of council documents such as the capital strategy, capital programme and monitoring reports, and of course in our activities, processes and culture.

It is a heavily regulated area which is governed by the CIPFA Code of Practice for Treasury Management, which the council has adopted in full. One of the requirements is an annually updated treasury management strategy. This activity occurs within a robust risk management environment, enabling the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. A risk assessment has been used in determining the 2007/08 policy and is contained within the council's risk register

The positioning of the treasury management strategy and the treasury policy statement within the council's financial framework is illustrated in the diagram below.

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Key Objectives

The medium term financial strategy sets out the main financial objectives of the council as relating to maintaining good underlying financial health, adoption of a longer-term perspective and a desire to deliver good quality, value for money services which are modern, efficient, effective, and fit for purpose. This requires a framework that delivers both transformation and core strength.

Our eight key financial objectives are to ensure that:

1. Our financial planning and management contributes to the transformation, development and improvement of the organisation through policy-led resource allocation, the use of options appraisal, income maximisation, and the creation of headroom through savings and efficiency.

2. Our budget is set to enable delivery of the Council's defined priorities, ensuring that resources are allocated according to the corporate vision, aims, objectives and pledges.

3. Our financial standing is stable and sustainable, so we are able to meet our expenditure commitments throughout each financial year and end each financial year with the working balance broadly intact.

4. Our financial planning and budgeting is undertaken on a medium-term, policy led basis, to ensure that the impact of decisions of one year are reflected in the future outlook, and that future developments with financial implications are proactively identified and managed.

5. We seek to deliver value for money in what we do, consider this within the various aspects of our corporate planning, identifying efficiencies and improvement and demonstrating this in measurable ways.

6. We adopt a mixed economy of service provision, where partnership, joint ventures and commissioning, outsourcing, in-house provision, consortia and all other options for service delivery are explored, appraised, and implemented with the aim of delivering good services, value for money and continuous improvement.

7. We work with our external partners, (including but not restricted to: health, police, Education Walsall, third sector) to share and optimise resources, improve services, and deliver value for money.

8. Our budget is linked to performance measures so we can assess the effectiveness of resource allocation by using of a combination of performance indicators, trend analysis, benchmarking and year on year comparison.

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 2006

The above objectives are further supported by the treasury management strategy in which the objectives are as follows:

In order to achieve these aims in the most effective manner general and specific objectives have been developed to measure and guide borrowing and investment activities. These being:

Borrowing Objectives

The borrowing objectives are:

- To minimise 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 external debt outstanding will be less than 4.75%
- Average maturity date between 20 and 25 years
- Capital financing costs as a percentage of Formula Grant < 20%
- The gearing effect on capital financing estimates of 1% increase in interest rates increase must not be greater than 5%.

Investment Objectives

- The general policy objective for this council is the prudent investment of its treasury balances
- The council's investment priorities are:
  - o The security of capital and
  - o 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 > 4.7%
- Average interest rate received on STI Versus 7 day Libor rate – 0.1%
- Average rate on all investments >4.8%
- % daily bank balances within a target range of 97%
- A maximum of £20m is invested over a period over 365 days

Context

The TM strategy takes account of the prevailing economic environment and current and forecast interest rates. As always, it is difficult to predict accurately with many analysts making conflicting predictions. If confidence in world markets increases, the demand for gilts will decrease and yield rates on gilts will increase. PWLB interest rates tend to follow gilts so they may also increase. This time last year, economic commentators were expecting the Bank of England Base rate to steadily reduce in 2006/07. However, it has actually increased. For financial planning and budget setting purposes, it is assumed that interest rates will rise further in 2007/08 following which there will be a period of stability before interest rates drop back slightly in 2008/09. The treasury management panel receives regular reports on economic outlooks. Further detail is provided below.

For new borrowing, the recommended approach is to borrow long term to finance the capital programme at the lowest rate available during the year, and for short term borrowing and lending to be undertaken at the best rates available; consistent with low risk.

To integrate the TM strategy with the Code, the strategy also contains 5 specific aims that may be monitored and measured alongside the PCIs. The specific key objective is to maintain a balanced portfolio of debt with the average rate of less than 4.75% despite the expected pressure of interest rate rises discussed below. The investment rate target is increased to 4.8%, reflecting the recent rise in investment rates.

Economic Outlook

2006/07 has seen 3 increases in the UK Bank Base Rate and many economic commentators predict a further increase then a period of stability at this higher level. However, the money market levels and gilt edged yields, which have a more direct effect on our treasury management activity, are predicted to be very volatile over the coming three years. The economic cycle, once regarded in years, now can be concentrated into months as investors' sentiment and appetite for risk changes almost daily. Sterling interest rates and bond yields will be influenced by similar movements in other currencies; mostly notably the dollar and euro. It will not always be easy to predict short term movements correctly. Therefore, particularly for longer term borrowing, it is essential that capital requirements are known and can be covered at the appropriate time even by dealing forward.

The UK Economy

In the UK, the sole driving force has and will be the performance of the housing and retail markets and the level of borrowing. Since the lowest point of rates in 2001/02, world interest returns have risen mainly in unison, but along the way this huge influx of cheap liquidity has pushed asset prices way above their long term growth average. In this cycle, rising inflation levels are catching up with events and are forming a much higher base level which is likely to preclude inflation rates falling back significantly. However, the deflationary forces imported through cheap goods and labour from China, India and Eastern Europe are on the wane which will make Central Banks' job more difficult to reduce borrowing costs to stimulate flagging economies if required. The January 2007 bank base rise has been perceived as measure to curb pay awards and reduce rising inflation.

Market Reaction 2007/08

The US market was recently discounting three cuts from the middle of the year down to 4.5%. In the UK this is considered to be too optimistic; expecting only one at the very best. But it indicates how volatile current markets are. As a consequence, irrespective of whether the UK base rate rises again, the yield curve in the UK in 1-5 years is far too steep and we expect levels to fall back throughout the year. Meanwhile, the value of the dollar is likely to remain under pressure and this will inhibit the Federal Reserve's ability to reduce short term levels. Therefore, longer term rates, which are already discounting cuts in short term levels, will rise. Thus the council will be seeking opportunities to fix investments for periods of over 12 months.

2008/09 – 2009/10

Tradition, which provides the council with economic information are also pessimistic about interest rates falling back, even if there is a significant fall in the housing and retail markets, the Monetary Policy Committee will struggle to reduce rates by very much. Tradition view a base of 4 ½% as the best lower case scenario whilst we see the topside in the next cycle moving in the 5 ¼% - 5 ¾% range. If short term interest rates do not fall back, then investors will begin to demand higher returns from longer term investments and therefore potentially looking forward the current inversion in longer term levels will cease, resulting in yields pushing up ¾% - 1%. This will mean that the cost of long term borrowing may rise.

Appendices to the
Treasury Management & Investment Strategy

STRATEGIC PRINCIPLES

Our strategic principles relate to how we will deliver our overarching objectives, ensure good governance, a strong control environment within treasury management and consistently adopt a longer-term perspective in treasury management. Our strategic principles are considered within 5 categories set out in the following appendices A to E:

A	Borrowing requirements 2007/08 onwards and associated risks
B	Use of supported borrowing
C	Investments
D	Monitoring treasury management activities
E	Prudential indicators for 2007/08, 2008/09 and 2009/10

Appendix F provides more information on prudential indicators

A. BORROWING REQUIREMENTS 2007/08 ONWARDS & ASSOCIATED RISKS

Currently the main risk to be managed is the volatility of the variable interest rate changes. Rescheduling of loans in previous years has reduced the number of scheduled interest rate changes over the next five years from 36 to 15. The council's loan debt currently comprises 89% fixed rate loans and 11% at variable rate. The volatility could impact on the medium term financial strategy. The recent risk assessment undertaken shows a possible impact of between £0.100m and £0.400m. This will be managed by monitoring the movements of fixed and variable rates. The risk is also managed by taking new loans with at least a 5 year period of interest stability and also monitoring exposure periods up to 2040.

The return on the council's short term cash balances is also volatile but not as significant; it being dependent on both the level of balances and interest rates. The budget for 2007/08 is £2.5m. The recent risk assessment shows a possible negative impact of £0.32 m if interest rates drop by 0.5%. This will be managed by monitoring cash flows and available investment rates.

The final 2007/08 formula grant settlement has provided supported borrowing of £9.573m. **Table 1** shows the estimate of mainstream resources from 2005/06 to 2010/2011 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 £20m.

Table 1: Estimate of mainstream resources 2007/08 to 2011/12

Borrowing Type	2007/8 £m	2008/9 £m	2009/10 £m	2010/11 £m	2011/12 £m
Supported borrowing	9.573	9.573	9.573	9.573	9.573
Unsupported borrowing	17.661	8.338	5.499	4.848	4.848
Total borrowing	28.233	7.911	15.072	14.421	14.421
Capital receipts	5.000	5.000	5.000	5.000	5.000
Total	**32.233**	**22.911**	**20.072**	**19.421**	**19.421**

B. 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 now considered prudent for Walsall council to have a more planned use of capital receipts over the medium term and to consider 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 - 4.76%
- The final revenue settlement assumes an average borrowing rate of 5.9% in the calculation of formula grant
- 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 2007/08 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 unsupported borrowing costs. This will secure the best value for money option and optimize use of resources. For 2007/08 onwards, further use of USB is projected and included in the capital programme (see **Table 2).**

Table 2: unsupported borrowing 2006/07 to 2009/10			
	2007/8 £m	**2008/9 £m**	**2009/10 £m**
Regenerating Walsall	0.500	0.500	0.500
School building repair	2.000		
ICT	5.255		
USB instead of capital receipts	5.311	0.516	
Debt capacity – general support	4.595	7.322	4.999
Total	17.661	8.338	5.499
Additional debt capacity	1.000	1.000	1.000

In addition to the USB allocated to specific schemes, it is recommended that a further £1m is earmarked for projects that may come along throughout the year that can demonstrate with thorough option appraisal, that they are self funding. Section D discusses how additional USB is affordable and fits well with the profile of the Council.

C. INVESTMENTS

The ODPM maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful; this council will not engage in such activity. The council will maintain its investments in accordance with the ODPM's Guidance on Local Government Investments and CIPFA's Treasury Management in Public Services: Code of Practice & Cross Sectoral Guidance Notes ("CIPFA TM Code").

Investment balances / liquidity of investments

Based on cash flow forecasts, we anticipate fund balances in 2007/08 to range from £40m to £60m. Around £35m is expected to be received from capital grants, so there is significant scope for the management of cashflows.

The minimum proportion of the overall investments that the council will hold in short-term investments is currently 75%. These investments of less than 365 days are called specified investments. Considering the council's level of balances over the next 3 years, the need for liquidity, spending commitments and provisioning for contingencies, and the economic outlook, it is proposed that the council decreases the amount to 66%. This means that 34% (approximately £20m) of overall fund balances can be prudently committed to longer term investments (i.e. those with a maturity exceeding a year). These are called non specified investments.

Cash Deficits and Surpluses

Short term cash surpluses and deficits will arise regularly during the year. It is anticipated that most surplus cash will only be available on a temporary basis, as it will mainly represent working capital. Money Market Funds (MMFs) can also be used for short term investments, as monies can be repaid at short notice. Generally, short term deposits are most cost effective for short term cash surpluses. Therefore, investments will normally be made through short term deposits to specific dates, with reference to the cash flow requirements, but MMFs may be used if better returns can be achieved. Government regulations have allowed investment in AAA credit rated MMFs since 1.04.02, which have also shown returns above the normal 7 day rate.

Temporary loans, where both borrower and lender have the option to redeem within 12 months, are usually used to cover short term revenue cash deficits, pending the receipt of, for example, precept income. However, they may also be used to cover capital requirements in the shorter term until longer-term loans are taken out. Like deposits, most of these loans will be at fixed interest rates to specific dates.

Longer Term Cash Balances

Sometimes cash surpluses are of a longer term nature, such as core revenue balances, net creditors, accrued reserves and the PFI Sinking Fund. These balances can be used to cover financing requirements where long-term interest rates make it less cost effective to use long term loans. If longer term cash balances are not required in lieu of borrowing, these will be placed on deposit. However, it may sometimes be prudent to place these monies in MMFs or, for larger amounts, with external cash managers to improve the returns. The council currently has £15m invested over 1 year. It is considered prudent and advantageous given the economic outlook to increase this to £20m subject to the endorsement of the council's treasury management panel.

D. MONITORING TREASURY MANAGEMENT ACTIVITIES

The prudential indicators, required to be shown for a 3 year period, should not be used as comparisons between councils because of historical differences. Walsall participates in a national benchmarking club with 60 other councils. **Table 3** compares Walsall with the group's average in 2005/06. It shows that we have an exceptionally low interest rate on debt outstanding, an about average maturity profile, and should look to improve upon the return received on investments. If we had the average rate on debt outstanding the additional cost would be £2.4m

Table 3: comparison with other councils 2005/06			
	Walsall Council	**Average 60 participants**	**Difference £ m**
Average rate of return on external investment	4.76%	4.7%	3
Average rate on debt outstanding	4.71%	5.8%	2.420

Walsall council is a mid sized metropolitan authority. Of 36 metropolitan councils it has the 17th largest population and 20th largest revenue budget. **Table 4** shows that Walsall have used prudential borrowing at the upper quartile but that this is affordable - we are in the lowest quartile for financing costs, and in the lowest quartile for borrowing limits and the proportion of debts over 10 years old.

Table 4: comparison of prudential indicators Walsall Council v other metropolitan authorities 2006/07				
Prudential indicator	**Walsall**	**Lower Quartile**	**Median**	**Upper Quartile**
Financing costs to revenue streams	4.1%	4.31%	7.16%	9.32%
Operational limit for external debt	£228m	£201m	£365m	£491m
Maturity Structure 10 years & above limit	80%	90%	95%	100%
Budgeted unsupported borrowing	£12m	£6m	£8m	£17m

Further evidence that an increase in Walsall's unsupported borrowing is reasonable was revealed when examining more closely the benchmarking returns of 25 similar London and metropolitan authorities. Walsall's borrowing as a percentage of our annual budget was the 11th lowest and its increase to its capital financing requirement (CFR) was the 6th lowest. Thus for our profile of having mid range borrowing to budget and low financing costs it is reasonable to have a mid range increase in the CFR. The proposed USB increase of £18m, we estimate will move us only slightly to 12th position, still having a gearing of borrowing to budget less than the group average.

As Prudential Code Indicator 2 (PCI 2) discussed below shows the net capital financing costs are not significant in relation to the overall revenue budget. However, a major and unexpected shift in the level of interest rates would result in increased costs to the council. This risk is monitored through indicator L7 which measures the adverse effect of a 1% increase in interest rates.

Investment counterparty risk is controlled by using suitable criteria for assessing and monitoring the credit risk of borrowers and the construction of the lending list comprising time, type, sector and specific counterparty limits. This is authorised by the treasury management policy statement and was approved by cabinet in November 2006. The performance of brokers is reviewed on a quarterly basis to ensure best returns are achieved.

Monitoring of progress against the national and local indicators is undertaken throughout the year, particularly the two borrowing limits, which are kept under constant review. Cabinet will be kept informed of any issues that arise. Cabinet will also be kept up to date in the regular capital monitoring reports and in the interim treasury report in the autumn.

Within the operational boundary and authorised limit, the elements for borrowing and other long term liabilities are clearly identifiable and require approval by cabinet and Council. However, in order to give operational flexibility, cabinet are asked to delegate to the Executive Director (Chief Finance Officer) the ability to effect movements between the two elements, in accordance with the results of option appraisals and perceived best value for money for the authority (e.g. it may be most cost effective to fund elements of the capital programme from USB rather than via lease, or vice versa). Any such changes will be reported to the cabinet portfolio holder responsible for finance and to cabinet retrospectively.

E PRUDENTIAL INDICATORS FOR 2007/08, 2008/09 & 2009/10

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 5 details the proposed national prudential indicators for Walsall council from 200708 to 2009/10. More details on prudential indicators 11 and 12 are in section F**.**

Table 5: national prudential indicators 2007/08 to 2009/10				
No.	**Indicator**	**2007/8**	**2008/9**	**2009/10**
Comment				
PCI 1	**Total capital expenditure**	**70,685**	**35,856**	**35,933**
Reduces in later years due to uncertainty on future grants and other capital resources				
PCI 2	**Estimates of the ratio of financing costs to the net revenue stream**	**8.22%**	**8.81%**	**9.01%**
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 should be more revealing.				
PCI 3	**Estimates of the council tax that would result from the expenditure plans**	**£9.64**	**£10.27**	**£10.89**
This aims to show the notional impact of the capital investment decisions payback from services will be formally agreed.				
PCI 4	**Estimates of capital financing requirement**	**264,760**	**271,990**	**278,169**
This represents the underlying level of borrowing needed to finance historic 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**	**291,236**	**299,189**	**305,985**
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**	**264,760**	**271,990**	**278,169**
This has been set at the level of 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 section F**		
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 section F**		
See comment under PCI 9.				
PCI 13	**Upper limit for principal sums invested for periods longer than 364 days.**	**£20,000,000**	**£20,000,000**	**£20,000,000**
The council is also at risk when lending temporarily surplus cash. The risk will be limited by investing surplus cash in specified investments and by applying lending limits and high credit worthiness.				

Local PIs are shown overleaf.

Local Prudential Indicators

Table 6 sets out local prudential indicators proposed for 2007/08 to 2009/10.

Table 6: Local Prudential Indicators 2007/08 to 2009/10				
No.	**Indicator**	**2007/8**	**2008/9**	**2009/10**
Comment				
L.1	**Full compliance with 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 quick maturity measure and ideally should match the lifespan of assets.				
L.3	**Ratio of unsupported financing costs to revenue stream**	**0.73%**	**0.95%**	**1.03%**
Provides further detail on the significance of USB in relation to the total revenue budget				
L.4	**Actual debt versus operational debt**	**97.08%**	**97.13%**	**97.18%**
This monitors the authority's debt position.				
L.5	**Average interest rate of external debt outstanding**	**4.84%**	**4.93%**	**4.95%**
This is compared with the PWLB rate for loans with a maturity date of 20 years, which is equivalent to the average maturity date of loans outstanding.				
L.6	**Gearing effect on capital financing costs of 1% increase in interest rate**	**5%**	**5%**	**5%**
This integrates risk management into the monitoring of the TM strategy.				
L.7	**Average interest rate received on short term investment**	**4.7%**	**4.7%**	**4.7%**
A recognised PI for measuring the performance of the return on investments				
L.8	**Average interest rate received on STI Versus 7 day Libor rate**	**0.1%**	**0.1%**	**0.1%**
This compares the interest gained on surplus funds with the 7 day LIBOR rate which is the rate banks offer and is an accepted measure of performance.				
L.9	**Average rate on all investments**	**4.8%**	**4.8%**	**4.8%**
As L6. but includes investments longer than 364 days				
L.10	**% daily bank balances within target range**	**97%**	**97%**	**97%**
This measures how good our daily cash flow prediction is.				

F PRUDENTIAL INDICATORS – ADDITIONAL INFORMATION

	2007/08	2008/09	2009/10
PCI 10. 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 11. 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%

The monitoring of the indicators 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 CFO.

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
Cashflow 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.
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 conventions for interest. They are defined in the London Code of Conduct (“The London Code”) published by the Bank of England.
Non specified investment	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 local authorities' capital investment plans are affordable, prudent and 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 and its investments, the management of associated risks, and the pursuit of 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 strategy.
Variable debt	This is money which has been borrowed at a variable interest rate, and as such is subject to interest rate changes.
Unsupported borrowing	Borrowing taken through the powers of the Prudential support for which the council will not receive any government funding