Appendix C

Report of	Meeting	Date
Statutory Finance Officer	Special Council	1 March 2011

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

PURPOSE OF REPORT

1. To set prudential indicators for the years to 2013/14, and to recommend criteria to be followed in treasury operations in 2011/12.

RECOMMENDATION(S)

2. That Council approves the following:
   - The Prudential Indicators for 2011/12 to 2013/14
   - The Treasury Management Strategy for 2011/12, incorporating the Treasury Prudential Indicators
   - The Annual Investment Strategy 2011/12
   - The Annual MRP Policy Statement 2011/12

EXECUTIVE SUMMARY OF REPORT

3. This report outlines the Council's prudential Indicators for 2011/12 to 2013/14, and sets out the expected treasury operations for this period. It also states the policy for making the minimum provision for repayment of debt. It should be considered together with the Council's financial strategy, budget and council tax proposals for 2011/12
   The strategies incorporate the changes in investment limits approved by Executive Cabinet on November 11th. No other strategic changes are proposed.

REASONS FOR RECOMMENDATION(S)
(If the recommendations are accepted)

4. It is a statutory requirement that Councils approve the policies, indicators and statements addressed in this report prior to the commencement of each financial year.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

5. None

CORPORATE PRIORITIES

6. This report relates to the following Strategic Objectives:

Strong Family Support		Education and Jobs	
Being Healthy		Pride in Quality Homes and Clean Neighbourhoods	
Safe Respectful Communities		Quality Community Services and Spaces	
Vibrant Local Economy		Thriving Town Centre, Local Attractions and Villages	
A Council that is a consistently Top Performing Organisation and Delivers Excellent Value for Money			X

BACKGROUND

7. The Local Government Act 2003, has given authorities greater discretion over capital expenditure through prudential borrowing, and made compliance with CIPFA's Prudential Code and CIPFA's Treasury Management Guidance, statutory requirements. The former requires the production of Indicators showing that expenditure is affordable, the latter requires the approval of an annual Treasury Management Strategy incorporating Treasury Indicators and limits.

8. Consequential to the Prudential Borrowing powers is a requirement that authorities should make prudential provision for the repayment of borrowing (MRP). This is to be the subject of an annual policy statement to be made to the full Council prior to the start of each year.

9. Finally Authorities have, through the Local Government Act 2003, also been given greater discretion in investing surplus cash. They are required however, by guidance issued by the CLG, to prepare an annual Investment Strategy to identify how that discretion should be applied.

10. This report therefore brings together these related requirements by submitting, for the approval of Council, the four statements.

DETAIL

11. The detailed statements and strategies etc are attached

IMPLICATIONS OF REPORT

12. This report affects the following areas. The relevant Directors' comments are attached:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal	✓	No significant implications in this area	

COMMENTS OF THE STATUTORY FINANCE OFFICER

13. This report meets statutory requirements. Its statistical content is consistent with the assumptions made in the revenue and capital budgets. The criteria it recommends will direct the Council's treasury operations in 2011/12.

GARY HALL
STATUTORY FINANCE OFFICER

Document	Inspection
Financial Strategy/Budget and Council Tax 2011/12 Treasury Management in the Public Services: Code of Practice CIPFA Prudential Code for Capital Finance in Local Authorities	Town Hall

Report Author	Ext	Date	Doc ID
G Whitehead	5485	2/02/2011	Treasury Strategy

PRUDENTIAL INDICATORS 2011/12 to 2013/14

Local Authorities have discretion to incur capital expenditure in excess of the capital resources provided by government, or those resources resulting from the sale of assets or the receipt of contributions from other parties.

To manage that process the Council must consider the following Indicators. These are designed to indicate that the expenditure is prudent and affordable.

Prudential Indicator 1 - Capital Expenditure

The following statement summarises the Capital Programme. It shows the use of prudential borrowing is intended. Provision for the revenue costs (interest effects and debt repayment) has been built into the revenue budget.

Table 1 – Capital Expenditure	2010/11 Revised £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
The Council's capital expenditure.	4,587	5,900	1,114	780
Less Capital resources				
capital receipts	(218)	(30)	0	
contributions	(1,596)	(4,026)	(90)	
Grants	(582)	(1,113)	(260)	0
Revenue and reserves	(1,447)	(205)	(120)	(250)
Balance – met from prudential borrowing	744	526	644	530

Prudential Indicator 2 – Capital Financing Requirement (CFR)

The CFR is a measure of the Council's indebtedness resulting from its capital programme. Such expenditure is funded from leasing, borrowing or, temporarily, by the use of the Council's internal cash balances. Ultimately it will be discharged by charges to the revenue account or by the use of available capital resources (such as grants, contributions or capital receipts). The following table shows the CFR as at the end of each financial year and the reasons why it has changed in that year:

Table 2 - CFR	2010/11 Revised £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Estimated CFR at period end	9,995	9,414	9,714	9,878
Less planned voluntary set aside in 2010/11	(771)			
	9,224			
Reasons for the annual change in the CFR				
prudential borrowing in year		526	644	530
estimated MRP (net of £100k reduction resulting from voluntary set aside)		(336)	(344)	(366)

This does not reflect the intention, referred to in the Medium Term Financial Strategy, to further restructure debt repayment from 2011/12 onwards.

Prudential Indicator 3 – Ratio of financing costs to the net revenue stream

This indicator shows the proportion of the Council's budget (i.e. the costs it has to meet from government grants and local taxpayers), that is required to meet the costs associated with borrowing (interest and principal, net of interest received).

Table 3 – Ratio of financing costs	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
Ratio	5.72	5.86	6.71	7.12

Prudential Indicator 4 – Incremental impact of capital investment decisions on the band D Council Tax

Table 4 – Impact of capital investment decisions	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £
Increase in Band D charge	0.01	0.21	(0.21)	1.34

This table shows the cumulative effect on council tax levels of the changes between the capital programme reported in this strategy and that submitted a year ago.

Last years strategy started at 2009/10 and this years runs through to 2013/14, a period of 5 years. In that time there have been changes not only in cost but also in the phasing and methods of financing the programme. Overall the only significant change is caused by the addition of a 2013/14 programme reliant on revenue funding and prudential borrowing. There is also an increased cost in 2011/12, the result of greater use of revenue funding in that year, but this is offset by an equivalent reduction in revenue funding in the following year.

TREASURY MANAGEMENT STRATEGY 2011/12

1. Background

The treasury management service fulfils an important role in the overall financial management of the Council's affairs. Whilst the prudential indicators shed light on the affordability and consequence of capital expenditure plans, the treasury service deals with any consequential borrowings, and the management of cash balances.

Prudential Indicators 5 and 6

The Council has a statutory obligation to have regard to the CIPFA Code of Practice (revised in 2009), and is required to adopt both the Code and the Treasury Management Policy Statement therein. Both of these were adopted by Council on 2 March 2010 (Financial Procedure Rule 4 refers)

2. Reporting

This strategy statement has been prepared in accordance with the revised Code. As a minimum, a mid year monitoring report and a final report on actual activity after the year end, will be submitted to the Council. It is intended to additionally report to the Audit Committee during the year.

3. Borrowing and Investment Projections

The Council's borrowings and investment are inter-related. The following table details the expected changes in borrowings, consistent with the capital and revenue budgets, and the balances available for investment at each year end.

Table 5 – Borrowing and Investments	2010/11 Revised £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Borrowing at period start	2,267	8,872	7,822	7,305
Borrowing repaid in year	(1,541)	(1,050)	(550)	(350)
Borrowing in year	8,146	0	33	530
Est. borrowing at period end	8,872	7,822	7,305	7,485
Est. surplus cash available for investment	(6,193)	(400)	0	0
Net borrowing	2,679	7,422	7,305	7,485

It will be noted that net borrowing increases throughout the period. The major factor causing this is the capital programme totalling nearly £8m over the period 2011/12 to 2013/14. This uses up resources already held by the Council (e.g. capital contributions held to fund works), and it also relies on prudential borrowing totalling £1.7m over the years 2011/12 to 2013/14.

Additional borrowing may be necessary in 2012/13. This is commented on in paragraph 5 below.

Prudential Indicator 7

The Prudential Code requires authorities to make comparison between net borrowing and the CFR. At its greatest net borrowing should not exceed the current years CFR plus the estimated increases in CFR for the following two years. The figures reported above meet this requirement.

Prudential Indicator 8 The Operational Boundary for External Debt

The Council is required to set two limits on its borrowings. The first is the Operational Boundary. This should reflect the most likely, but not worst case scenario consistent with the Council's budget proposals.

The basic cash position is shown in table 5 above i.e. that the surplus cash available for investment is expected to be exhausted by 2012/13, and that small borrowings are likely to be necessary thereafter. The Operational Boundary needs to reflect this, and also the possibility that larger borrowings will be taken to pre-empt rises in interest rates. The following Operational Boundary is therefore proposed:

Table 6 – Operational Boundary	31/3/11 Estimate £'000	31/3/12 Estimate £'000	31/3/13 Estimate £'000	31/3/14 Estimate £'000
Borrowings	8,872	10,000	10,000	10,000
Other long term liabilities	13	13	13	13
Operational boundary	8,885	10,013	10,013	10,013

Prudential Indicator 9 The Authorised Limit

This is the second limit. It should allow headroom above the Operational Boundary to accommodate the fluctuations that can occur in cash flows. The following is proposed:

Table 7 Authorised Limit	31/3/11 Estimate £'000	31/3/12 Estimate £'000	31/3/13 Estimate £'000	31/3/14 Estimate £'000
Borrowings	9,000	12,000	12,000	12,000
Other long term liabilities	13	13	13	13
Authorised limit	9,013	12,013	12,013	12,013

4. Economic outlook and expected movement in interest rates

The advice of the Council's consultants is attached at Appendix A.

Not surprisingly they stress the huge economic uncertainties, and conclude that the overall balance of risk is still to the downside. They expect base rate to remain at 0.5% until the autumn of 2011, and warn of rising PWLB rates in reaction to the high volumes of government debt.

5. Borrowing strategy

The Council's cash resources are expected to be virtually eliminated by 31 March 2012 and thereafter there will increasingly be times when it may need to borrow. There are two borrowing strategies:

- The modest borrowings shown in Table 5 could probably be avoided for most of the year by taking advantage of seasonal revenue cash flows (i.e. the Council usually receives its income in the first ten months thus creating a cash surplus which unwinds in the last two months of the year). Temporary borrowing would be taken if and when there was a shortfall. This may offer the cheapest short term solution.
- Alternatively longer term, more strategic borrowings will be considered in light of anticipated movements in interest rates

Treasury Management Limits on Activity

The Authority is required to set the following Treasury Indicators. The purpose of these is to minimise the risk resulting from movements in interest rates.

Treasury Indicator 1 – Upper limit on Variable rate exposure

The Council is exposed to interest rate movements on its invested cash. This varies significantly over the course of the year, and during each month. During the current year balances peaked at just below £20m for short periods. This amount will therefore form the limit

	2010/11 Revised	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
Upper limit on variable rate exposure -	£20m	£20m	£20m	£20m

Treasury Indicator 2 – Upper limit on fixed rate exposure

The Council is exposed to fixed rate interest on any long term liabilities and PWLB borrowings. The maximum estimated exposure is based on the Operational Boundary (PI 9 above).

	2010/11 Revised	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
Upper limit on fixed rate exposure	£10.0m	£10.0m	£10.0m	£10.0m

Treasury Indicator 3 - Maturity structure of borrowing

The Council is required to determine upper and lower limits for the maturity structure of its debt. The following limits reflect the structure of existing borrowing and will accommodate possible borrowings in 2011/12.

	As at 31/3/2012	
	Lower Limit	Upper Limit
Under 12 months	0%	50%
12 months to 2 years	0%	50%
2 to 5 years	50%	100%
5 to 10 years	0%	50%
10 years and above	0%	0%

Treasury Indicator 4 – Total principal sums invested for greater than 364 days

It is not planned to make any investments for periods over 364 days.

7. Use of Treasury Advisors

The Council has contracted with Sector treasury Services as its treasury advisor for the period to 31 March 2013.

8. Performance Indicators

Investments – the generally accepted indicator is 7-day LIBID (The London Interbank Bid rate). This is the rate that could be obtained by the “passive” deposit of money onto the money market. Active investment, in normal times, should outperform this. It is recommended that this be set as an indicator.

INVESTMENT STRATEGY 2011/12

1. Introduction

1.1 Under the Power in Section (15) (1) of the Local Government Act 2003 the CLG has issued Guidance on Local Government Investments. This was updated with effect from 1 April 2010. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity. This strategy follows the updated guidance.

1.2 The major element in the guidance is that authorities should distinguish between lower risk (specified investments), and other investments (non-specified). These terms are explained in more detail below.

1.3 The specific issues to be addressed in the Investment Strategy are as follows:

- How "high" credit quality is to be determined
- How credit ratings are to be monitored
- To what extent risk assessment is based upon credit ratings and what other sources of information on credit risk are used
- The procedures for determining which non specified investments might prudently be used
- Which categories of non-specified investments the Council may use
- The upper limits for the amounts which may be held in each category of non- specified investment and the overall total.
- The procedures to determine the maximum periods for which funds may be committed.
- What process is adopted for reviewing and addressing the needs of members and treasury management staff for training in investment management.
- The Authority's policies on investing money borrowed in advance of spending needs. The statement should identify measures to minimise such investments including limits on (a) amounts borrowed and (b) periods between borrowing and expenditure

2. Chorley Strategy 2011/12

<u>Objectives</u>

2.1The Council's investment priorities are:
- The security of capital and
- The liquidity of its investments.

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

2.3 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. The Council will restrict borrowing to a maximum of that envisaged to be required in the following eighteen months.

<u>Use of Specified and Non-Specified Investments</u>

2.4 Specified investments are those made~~:~~
- with high "quality" institutions, the UK Government or a local authority,
- for periods of less than one year and
- denominated in sterling.

Other investments are "non-specified". These could include investments in gilts, bond issues by other sovereign bodies and those issued by multilateral development banks, commercial paper, and any deposits for a period exceeding one year.

In 2011 the Council will continue to restrict its investments to those which are specified.

Counterparty Selection Criteria

2.5 In determining which institutions are “High Quality” the Council uses the creditworthiness service provided by Sector. This combines the credit ratings from all three rating agencies (Fitch, Moody, Standard and Poor) in a sophisticated modelling process. It does not however rely solely on these ratings, but also uses

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

These factors are combined in a scoring system, and results in counterparties being colour coded:

- Purple – recommended maximum duration 2 years
- Blue (used for nationalised and semi nationalised UK Banks)– 1 year
- Orange – 1 year
- Red – 6 months
- Green – 3 months
- No colour – not to be used

2.6 The Council has also chosen to restrict lending to UK financial institutions. Currently no such institutions attract a purple colour code.

2.7 The Council may use AAA rated Money Market Funds.

2.8 The Council may lend to the UK Government (which includes the Debt Management Office)

2.9 The Council may lend to other Local Authorities

Monitoring of Credit ratings

2.10 Sector supply rating warnings and changes immediately following their issuance by the rating agencies. The colour coded counterparty lists are reissued weekly, updated by such changes.

Time and money Limits

2.11 The time and money limits were changed by Executive Cabinet on November 11 2010. No further changes are proposed. The limits applying to each category of institution are specified in the attachment to this report

Member Training

2.12 Member training was provided in 2010. Further training will be provided when required.

Current list of Financial Institutions and Investment Criteria

(Executive Cabinet 11/11/2010)

Category	Institutions	Sector colour code	Sovereign rating	Max period	Limit per Institution
Sovereign or Sovereign "type"	DMADF Local Authority UK Govt backed Money market funds			6 months 1 year n/a instant access	No limit £3m £3m
UK Nationalised Institutions	None (N Rock deposits no longer guaranteed)				
Institutions guaranteed by other governments	None (Irish Banks are guaranteed but have been removed from the list)				
UK Partly nationalised institutions; with access to the Credit Guarantee Scheme	RBS group (inc Nat West) Lloyds Group (inc HBoS & Lloyds)	Blue Blue	AAA stable from all 3 agencies	1 year 1 year	£3m per group £3m per group
Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander UK Barclays, Nationwide	Orange Moves between red and green	AAA stable from all 3 agencies	1 year 6–3 months	£2m £2m
Money Market Funds	Standard Life Global liquidity MM Fund	Aaa/MR1+		instant access	£3m
Deposit/Call Accounts	Santander, Bank of Scotland, Nat West Lancs CC			Call accounts with instant access	£3m less value of term deposits

Note - Under the Credit Guarantee Scheme certain "eligible institutions" have access to liquidity from HM Treasury if required.

Note – Deposits with any one institution shall not exceed £3m

ANNUAL STATEMENT OF MRP POLICY 2011/12

Regulations specify that the minimum provision that a Council must make for the repayment of its debt. This is referred to as the MRP.

The Council will assess their MRP for 2011/12 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP for 2011/12 relates to debt incurred prior to 2008/9. MRP will continue to be charged on this at the rate of 4%, in accordance with option 1 of the guidance. There are some capital schemes since then which generate a further MRP liability (i.e. capital expenditure which is not financed by any grant or contribution e.g. vehicles). The MRP liability on this will be based on the estimated useful life of the asset, using the equal annual instalment method of calculation (option 3 of the guidance).

Estimated life periods will be determined under delegated powers with reference to the guidance. As some types of capital expenditure are not capable of being related to an individual asset, the MRP will be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

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APPENDIX A

The following is the advice of the Council's consultants – Sector (February 2011)

"Economic outlook and expected movement in interest rates

The interest rate forecast is as follows:

	Mar-11	June-11	Sep-11	Dec-11	Mar-12	Sep-12	Mar-13	Sep-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	3.00%	3.25%
5yr PWLB	3.30%	3.30%	3.40%	3.50%	3.60%	3.90%	4.30%	4.80%	5.00%
10yr PWLB	4.40%	4.40%	4.40%	4.50%	4.70%	4.90%	5.10%	5.30%	5.40%
25yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.50%	5.60%	5.70%
50yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.50%	5.60%	5.70%

Global economy

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland, is currently in progress as at November 2011.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors not expected to be enduring; general expectations are for anaemic (but not negative) growth in 2011 in the western world.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. The first estimate of +0.8% for quarter 3 was also unexpectedly high. However, the outlook is for anaemic growth in 2011/12 although the Bank of England and the Office for Budget Responsibility are forecasting near trend growth (2.5%) i.e. above what most forecasters are currently expecting.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July 2010 with small increases which are likely to be the start of a new trend for some years ahead of rising unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April and has gradually declined to 3.1% in September (RPI 4.6%). Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years after another rise back up to about 3.5% by the end of 2010.

The Bank of England finished its programme of quantitative easing (QE) with a total of £200bn in November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, have evaporated after the surprises of the Q3 GDP figure of +0.8% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's view is that there is unlikely to be any increase in Bank Rate until the end of 2011.

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June, Sterling strengthened against the

US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates.

Sector's forward view

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in our major trading partners - the US and EU
- the danger of currency war and resort to protectionism and tariff barriers if China does not address the issue of its huge trade surplus due to its undervalued currency
- the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
- changes in the consumer savings ratio
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- the potential for more quantitative easing, and the timing of this in both the UK and US, and its subsequent reversal
- the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.